

Section III Asset Management

Chapter 3 General Loan Oversight

3.0.0

Introduction

This chapter addresses details of loan servicing for projects insured under the Section 232 Program covered by this Handbook, and the related necessary actions for the Project (consisting of the Borrower, Operator, Master Tenant (if applicable) and Management Agent), Servicer and the Office of Residential Care Facilities' (ORCF) Account Executives (AE). For the purposes of this chapter, the term "Servicer" means the primary servicer responsible for servicing the mortgage loan, whether such party is the originating Lender or third party servicer for the originating Lender.

ORCF provides asset and risk management of all Section 232 insured projects; however Servicers must also provide routine reviews of their portfolio, which includes quarterly and annual reviews of financial performance as discussed in Asset Management, Chapter 4, as well as special reporting to the AE when a project's performance is at risk. This chapter provides guidance regarding performance benchmarks for each project, and also regarding the necessary actions to be taken by the Servicer, AE and project in specific circumstances during the life of the FHA insured mortgage.

Many tools and resources are posted on the Section 232 Program website, to include submission checklists, average processing times, and other helpful information that can provide supplemental guidance to this Handbook.

Section 3.1

Servicing and Monitoring of Construction Projects

3.1.1

Introduction

This section provides ORCF asset management guidance for Section 232 and 241(a) mortgage loans that include lease-up of units (new construction, substantial rehabilitation, blended rate, and Section 241(a)) (“– Construction Projects.”)

The risks inherent during the construction and lease-up processes necessitate heightened lender attention during those periods, as well as strong production/asset management coordination within the lender’s organization. The risks also necessitate strong lender leadership and lender coordination with all involved parties.

Within ORCF, and in light of the unique risks inherent during construction and lease-up, a Construction Project will typically (though not invariably) be assigned to an AE on a servicing team focused on servicing such properties (a “lease-up” servicing team). Generally the lease-up AE will then service the property until it reaches sustaining occupancy (see Sec. 3.1.—3.A.2.f). Although the AE will be the primary facilitator within ORCF, during the lease-up process the AE will, where appropriate, draw upon the participation of the ORCF Underwriter, Closer, Construction Manager, Appraiser and others within ORCF, as well as the assigned closing attorney from the HUD Office of General Counsel (OGC).

In its leadership role, and in close coordination with the lease-up AE, the Lender is expected to assemble--and electronically convene frequently (typically at least monthly)-- a resource team to assist the Lender in project monitoring. This “Project Monitoring Team” shall include where appropriate and without limitation the Borrower, Operator, Management Agent and ORCF. Drawing upon the information and expertise thus available, the Lender shall monitor ~~the~~ the actual lease-up progress compared to the projected (underwritten) progress, and shall assure that its Borrower identifies and carries out steps to remedy unfavorable variations between projected and actual progress.

~~**Asset Management Principle.** Early and continuous involvement of asset management staff with construction projects is essential due to a) the elevated business risk of failure associated with leasing up projects; and b) if applicable, the varied risks of performing construction in direct proximity to residential health care.~~

~~A construction team, including two AEs in Asset Management, will work closely with the Production staff to ensure a seamless transition between the two divisions. These two construction AEs will be assigned to all projects until the project is performing as projected and deemed stabilized in the market.~~

~~When possible, the monitoring of construction projects is initiated by ORCF asset management staff prior to a project opening and is continued until a project demonstrates self-sustaining operations. It has been HUD's experience, that the critical start-up period demands proactive collaborative monitoring by the Borrower, the Lender, Operator, Management Agent, and ORCF. Even after a project has attained self-sustaining operational status, its success is not guaranteed and it must be monitored carefully until it has permanently established itself in the marketplace.~~

3.1.2

Organization and Responsibilities

~~Proper asset management of Section 232 and 241(a) construction-related healthcare projects requires a team approach, and a clear understanding among assigned staff, of the roles and responsibilities of the parties involved. ORCF will assign an AE for each project to serve as the primary facilitator, but the "start-up" requirements of construction projects may require the participation of the ORCF Underwriter, Closer, Construction Manager, Appraiser and others as necessary. Additionally, the assigned closing attorney from the HUD Office of General Counsel (OGC) may also need to be involved. The Lender and the Borrower must be part of the team as well. Also, for projects that were originated under MAP guidelines by the Office of Multifamily Housing field offices, representatives from the originating HUD Multifamily office may also need to participate.~~

3.1.23

Loan Committee Presentation and Initial Closing

~~Just as the Lender coordinates its own production and asset management functions, so too does ORCF. In that regard, To ensure that the lease-up AE Construction team has the opportunity to fully appreciate the issues, objectives and risks of the construction loans as described above, the lease-up AE's assignment will typically begin with attendance and participation in the project's loan committee presentation. Then, upon issuance of a Firm Commitment, the ORCF Closer staff will facilitate many functions necessary for the Initial Closing, and the AE will work with the Closer and/or the ORCF Construction Manager where needed, leading up to Initial Closing. The following summarizes the usual asset management process through initial closing:~~

~~The AE construction team will participate in all official Loan Committees surrounding the construction projects with the ORCF Underwriter.~~

The AE attends the Loan Committee presentation to ensure familiarity with all the aspects of the new loan.

Upon issuance of a Firm Commitment, the Closer staff facilitates any functions necessary for the Initial Closing. The AE will work with the Closer and/or the Construction Manager as requested and as appropriate.

3.1.34

Asset Management Functions after Initial Closing

The lease-up AE's activity after Initial Closing varies according to the type of loan, which determines the asset management lead-time provided by construction.

A. **Projects Having No Operations During Construction.** In the case of a Section 232 construction loan where there are not existing operations that will continue during construction (new construction and some substantial rehabilitation projects), the project's construction phase will typically consume many months, during which time the AE's duties will be minimal. When a project of this type reaches the point of 70% completion (calculated as a percentage of construction draws), the ~~AE will be alerted via email by the Construction Manager, and the~~ AE will then commence ORCF's pre-operations asset management functions, ~~including facilitation of the "Pre-Operations Meeting"~~.

1. **Pre-Operations Activities.** ~~Key to a successful start-up is a well-orchestrated transition from the construction to business operations phases. During the construction phase, the AE may need to intervene in unusual circumstances when alerted by the Closer or Construction Manager; however as the project opening approaches, the AE becomes the facilitator of important project tracking activities.~~ When this type of project is scheduled to open within the following quarter, the AE will begin to work closely with the Lender, project participants and ORCF colleagues to help assure a successful transition and business start-up.

a. **ORCF Staff Communications.** The AE, the Construction Manager and the assigned Closer ~~will~~should communicate after Firm Commitment to ensure that all parties are aware of the project assignment. If project issues arise, the AE will participate as necessary to ensure appropriate resolutions. To keep the AE informed about construction progress, the Construction Manager will send an email notification to the AE when a new construction project reaches ~~50% completion, and again when the project reaches~~ 70% completion.

b. **Pre-Operations Meeting.** When a new project reaches 70% completion, the AE will confer with the lender regarding first convening a Project Monitoring Team (referenced above in the Introduction, 3.1.1). The lender, in coordination with the AE, will arrange and facilitate ~~at the~~ Pre-Operations Meeting of this Project Monitoring Team. Before doing so, however, the lender will, in coordination with the AE, collect project status information as needed and determine the appropriate participants and agenda. conference call.

The general purpose of the call is to promote the timely accomplishment of all operating preparations necessary to meet the scheduled business opening date and assure a smooth start-up. Prior to the meeting, the AE will collect project status information as required and determine the appropriate participants and agenda for the meeting. The AE will provide the Lender representative with a meeting announcement and agenda, along with the meeting materials, so that the Lender can distribute materials to all parties in advance of the scheduled meeting date.

i. ~~Participants shall include the Borrower, Operator and/or Management Agent (if applicable), the Lender representative, as well as ORCF and Multifamily Housing staff, as determined by the AE.~~

ii.i. ~~The agenda for this introductory Pre-Operations meeting will generally include, among other topics will cover the following:~~

1. Introductions
2. Pre-opening checklist, which the Borrower and Operator can use for guidance during start-up (Please see the Section 232 Program website,)
3. Borrower's summary of the marketing plan and current project status
4. Status of all state permits, i.e. Operating License, Medicaid/Medicare certifications
5. Discussion of the Initial Operating Deficit (IOD) tracking worksheet (Please see the Section 232 Program website)
6. Proper registration in the ~~B~~business ~~P~~partner ~~R~~egistration ~~S~~ystem (BPRS)
- 6.7. Assurance of borrower, operator and management agent's familiarity with the requirements of their respective regulatory agreements/certifications and other controlling documents

iii.ii. ~~Project issues may be discussed and resolved, or deferred to later meetings. In the case of Borrowers, Operators or Management Agents that are unfamiliar with ORCF requirements, it may be advisable to defer full discussions until later meetings as determined to be necessary. A suggested draft Pre-Operations Meeting agenda is provided on the Section 232 Program website.~~

c. Project Monitoring Strategy and Action Plan. The lender should assure that, Upon completion of the Pre-Operations Meeting, all participants have a clear understanding of the borrower's/operator's plan/strategy to reach sustaining occupancy, including problems identified, steps to address them, persons responsible, and benchmarks/timelines for follow-up. The lender should reiterate in writing promptly after this meeting (and subsequent Project Monitoring Team meetings) any the AE should be able to 1) make an initial risk assessment, 2) articulate a consensus strategy for resolving any existing issues, and 3) define an action plan for monitoring the progress on further activities required for the project opening. Any conclusions, agreements,

192 follow-up assignments, information requests, additional meetings schedule, etc.
193 ~~, should be reiterated in writing for all project team participants and also~~
194 ~~recorded in the HUD's integrated Real Estate Management System (iREMS)~~
195 ~~system.~~

196 197 198 199 2. Ongoing Asset Management Activities (After Project Opening)

- 200 a. General. The LenderAE will monitor the project's performance in accordance
201 with the plan established, and will meet with project participants as scheduled.
202 This includes facilitating the (monthly) Project Monitoring Team meetings, in
203 which the ORCF AE and, where appropriate, other ORCF representatives,
204 will participate, and in which actual progress is compared with projected
205 progress, and any corrective steps are identified, along with persons
206 responsible, target completion dates and benchmarks for progress.~~In the event~~
207 ~~that start-up issues arise or the project fails to meet the underwritten~~
208 ~~projections, the AE will intervene as necessary and will seek supervisory~~
209 ~~guidance and/or engage the ORCF Risk Mitigation Branch (Turnaround~~
210 ~~Team) as appropriate.~~
- 211 b. IOD tracking. The AE must approve any releases of IOD funds and will seek
212 to ensure that the funds are used judiciously by carefully tracking project
213 performance and the availability of remaining funds. Further information
214 regarding IOD funds is provided in the Escrow Accounts section of this
215 chapter.
- 216 c. IOD/Lease-up Tracking Worksheet. A project-specific IOD/Lease-up
217 tracking worksheet will be generated based upon the assumptions regarding
218 the project's lease-up ~~used in sizing the project's IOD escrow and placed in~~
219 ~~the IOD Library in the New Construction folder in SharePoint.~~ The AE will
220 forward the IOD/Lease-up Tracking Worksheet to the Lender to be forwarded
221 to the Borrower with other materials for the Pre-Operations Meeting. Lenders
222 ~~must will need to instruct~~ Borrowers ~~will be instructed~~ to complete and submit
223 the Worksheet on a monthly basis to the Lender, who will review and
224 promptly make available to the ORCF AE. The Worksheet will provide the
225 AE with the project performance documentation and justification necessary
226 for releasing funds from the IOD escrow account. This worksheet should be
227 addressed during the Project Monitoring Team meetings. Note that this
228 worksheet is important in lease-up transactions even when an IOD is not used;
229 the worksheet serves as an important tool for tracking actual versus projected
230 performance.
- 231 ~~d. IOD Tracking without the IOD Tracking Worksheet. In certain instances, an~~
232 ~~IOD Tracking Worksheet may be unavailable. In those cases it is incumbent~~
233 ~~upon the AE to either 1) generate a tracking worksheet based on underwritten~~
234 ~~projections, or 2) establish project-specific written agreements with the~~
235 ~~Lender and Borrower regarding a plan for utilization and preservation of the~~
236 ~~IOD funds.~~

e.d. Operating Reports. The Lender and AE needs regular project performance data to assess the overall health of the project. ~~It is essential that the AE specify exactly what project operating reports will be required. In the instance where the IOD Tracking Sheet is available, its submission~~ will provide them AE with a trended summary of monthly occupancy, revenue and expenses. The AE might also require that periodic financial statements (e.g., Balance Sheet, Statements of Profit/Loss, Cash Flows, Retained Earnings, Computation of Surplus Cash, AP and AR Aging Analysis) be submitted depending on how the project is performing. The HUD Monthly Accounting Reports (MAR) can provide valuable data as well.

f.e. Performance on surveys, inspections and certifications. Projects must survive initial regulatory scrutiny. Skilled Nursing Facilities (SNF) in all states undergo initial CMS compliance surveys in addition to Medicare and Medicaid certification reviews. Assisted Living Facilities (ALF) and Board & Care Facilities (B&C) are inspected in accordance with respective state rules. Issues with surveys and inspections can lead to lost or delayed revenues at a point where a new project's financial base is fragile. The LenderAE must communicate closely with Borrowers and Operators to remain abreast of progress on early regulatory reviews and must keep the AE informed.
g. iREMS updates to the project record. The AE must carefully track and summarize project start-up status in ~~the Risk Management section of~~ iREMS. Monthly entries are appropriate.

h.f. Achievement of Self-sustaining Occupancy operations. For servicing purposes, Aa project of this type attains self-Ssustaining Occupancy performance when all escrows established at closing (other than long-term escrows) are released but then only if the project also when it demonstrates, over a six (6) consecutive month periods of:

- i. An average Debt Service Coverage Ratio equal to or greater than 1.450 (including funding of all required escrows)
- ii. Timely and full mortgage payments on a Finally Endorsed loan, and
- iii. No regulatory issues

When Sustaining Occupancyself-sustaining performance is acknowledged by the AE, the project, if serviced by a lease-up AE, it must be recorded in iREMS and the status should be changed to "Not Troubled". will generally be transferred to an AE on a regular servicing team for routine monitoring and servicing.

- B. **Projects Continuing Existing Operations During Construction.** For Section 232 and 241(a) construction loans where existing operations will continue during construction (including blended rate, and some substantial rehabilitation projects), the AE must begin asset management duties with respect to the new loan immediately after Initial Closing. Typically the ORCF servicing (for both the new loan and, if applicable, the existing loan) will be assigned to an AE on the "lease up" servicing team for these transactions. However,

on 241a transactions in which the debt service coverage ratio for both loans exceeds 1.45 based on current revenue, the project will not likely be transferred to a lease-up AE for servicing.

1. General. Servicing of these loans generally involves all the elements and challenges of a new construction transaction, plus all the requirements related to ongoing servicing of a project currently in operation. Additionally, On these loans, the element of construction itself can create immediately raises the risk to the project due to resident, visitor and staff safety issues. Furthermore, renovating existing projects often uncovers project issues that were unknown at the time of underwriting, and the scope, duration and cost of construction sometimes changes. Those unexpected changes may raise asset management issues that require the the Lender's and AE's attention.
2. Timing. Upon Initial Closing of the loan the AE, having participated in Loan Committee and gained information about the transaction, will promptly initiate project communications and commence project monitoring and servicing functions related to the new loan. There is no lead time for construction, nor are there "Pre-Operations" activities required. As indicated in Section 3.1.4, the AE's participation at the LC review of the project proposal should provide prior knowledge about the project. The AE should be prepared for the uncertainties of renovation and the potential impact that construction plan changes may cause for the resident population. Issue resolutions will typically involve collaboration among the Construction Manager, UW, and Closer, along with the AE.
3. Initial Meeting. Although not a "Pre-Operations" meeting (as was the case above involving a completely new facility), the the AE will confer with the lender regarding first convening an initial meeting (conference call) of the Project Monitoring Team (referenced above in the Introduction, 3.1.1). The lender, in coordination with the AE, will arrange and facilitate this initial meeting. Before doing so, however, the lender will, in coordination with the AE, collect project status information as needed and determine the appropriate participants and agenda. That initial meeting will typically cover, without limitation: The AE will schedule to meet with the Lender, Borrower, and general contractor (if appropriate) and establish a communications routine and schedule. An initial conference call meeting involving participants determined by the AE, shall cover the following matters:
4. Introductions
 - a. Borrower's summary of the plan to continue operations during construction
 - b. Review of issues and plans for resolution (significant issues may require additional follow-up meetings for resolution)
 - c. Review the status of all permits (e.g., Certificate of Occupancy, operating license, etc.)
 - d. Discussion of working capital and IOD/Lease-up tracking if applicable
 - e. Confirmation or discussion to ensure registration in the Business Partner Registration SystemBPRS

f. Assurance of ~~of~~ borrower, operator and management agent's familiarity with the requirements of their respective regulatory agreements/certifications and other controlling documents ~~Assess the Borrower's and/or Operator's knowledge of ORCF requirements and provide guidance accordingly~~

g. Status of progress toward final closing

~~g.h.~~ Scheduling of the subsequent (monthly) meeting of the Project Monitoring Team

~~5.3. Project Monitoring Strategy and Plan. Upon completion of the conference call~~ The lender should assure that, upon completion of the initial meeting, all participants have a clear understanding of the borrower's/operator's plan/strategy to reach sustaining occupancy, including problems identified, steps to address them, persons responsible, and benchmarks/timelines for follow-up. The lender should reiterate in writing promptly after this meeting (and subsequent monthly Project Monitoring Team meetings) any conclusions, agreements, follow-up assignments, information requests, additional meetings scheduled, etc. The Lender should assure that IOD/Lease-up Tracking Worksheet is updated for these meetings, as a tool for comparing actual versus projected progress. ,the AE should be able to make an initial risk assessment and articulate the consensus strategy for resolving any existing issues and for monitoring further activities required for opening. Any conclusions, resolutions, agreements made, follow-up assignments, the plan for follow-up meetings, etc., will be reiterated in writing for all project team participants and also recorded in the HUD iREMS system.

~~6. Achievement of Self-sustaining Occupancy operations. See definition in Sec. A.2.f above. When Sustaining Occupancy is reached, the project, if it had been with a lease-up AE, will typically be assigned to an AE on a regular servicing team for routine monitoring and servicing. A project of this type attains self-sustaining performance when it demonstrates six (6) consecutive months of:~~

~~7. Debt Service Coverage Ratio equal or greater than 1.0 (including funding of all required escrows)~~

~~8. Timely and full mortgage payments on a Finally Endorsed loan~~

~~9. No regulatory issues~~

~~10. When self-sustaining performance is acknowledged by the AE, it will be recorded in iREMS and the Risk Classification changed to "Not Troubled".~~

C. **Projects Having Early Commencement of Construction.** With projects that are approved for early commencement of construction, the AE will be alerted to the project by the Underwriter, and the Construction Manager will monitor the construction activities. If a Firm Commitment is issued, the AE will immediately initiate asset management functions. Similar to other construction loans, the AE will work with the Lender, who will, drawing on a Project Monitoring Team, make an initial risk assessment, define a monitoring plan, and specify reports requirements ~~and document accordingly in iREMS.~~

After Firm Commitment, projects that have been previously approved for early commencement will thereafter be monitored in accordance with the asset management guidelines [above](#) for the specific type of construction loan until the project attains [Sustaining Occupancy](#) (as discussed above).

3.1.5

Monitoring and Lease-up Tracking Until Self-Sustaining Performance is Achieved

~~ORCF monitors the “lease-up” of all Section 232 and 241(a) loans that result in additional beds being added to a market. The Construction AE(s) will monitor the lease-up projections outlined in the appraisal and communicate back to the Production team.~~

3.1.6

ORCF Program Compliance

All Section 232 FHA-insured projects are governed by statutes, regulations and controlling documents. Borrowers and other program participants are obligated to comply with ORCF program obligations or be subject to program enforcement remedies. The assigned AE must ensure all participants have been informed relative to their program obligations.

Prior to the initial/final closing of a project, the AE will schedule a conference to review all pertinent matters regarding servicing of FHA-insured projects. A sample of the pre-closing or pre-occupancy conference agenda is available on the Section 232 website.

Section 3.2

Escrow Accounts

3.2.1

Introduction

- A. **Residential Care Facilities:** An FHA-insured Residential Care Facility will typically have one or more of the following types of escrow accounts (each one, hereinafter referred to individually, as an “Escrow Account” and collectively, as the “Escrow Accounts”):
1. Reserve for Replacement (Refer to 3.2.2 below)
 2. Residual Receipts (Refer to 3.2.3 below)
 3. Non-Critical Repairs (Refer to 3.2.4 below)
 4. Sinking Fund (Refer to 3.2.5 below)
 5. Mortgage Reserve/Debt Service (Refer to 3.2.6 below)
 6. Initial Operating Deficit (Refer to 3.2.7 below)
- B. **Escrow Accounts:** Each Escrow Account has a specific purpose, but all such accounts are intended to protect the interest of the Borrower and FHA mortgage insurance fund. Escrow Accounts are either required by Federal regulations, Regulatory Agreements, contractual agreements established during the underwriting of a project loan or contractual agreements executed subsequent to an initial loan closing. The Escrow Accounts are required to be used for specific purposes as outlined in this chapter or in the escrow agreement. The disbursement process requires cooperation between ORCF, the Borrower and the Lender. This chapter sets forth the general requirements for the maintenance of Escrow Accounts and the procedures to request a withdrawal or disbursement from each of the accounts.
- C. **Pending Loan in Review:** If an existing FHA-insured project has a pending application for a 223(a)(7) loan refinance or for any other FHA program, the Borrower must disclose information on a pending loan application of any request for a disbursement from an Escrow Account. Large unanticipated withdrawal requests may affect the financial information required for ORCF to process the pending loan application.
- D. **Specific Escrow Requirements:** ORCF may determine that a requirement that applies to one type of Escrow Account is also applicable to another Escrow Account.

3.2.2

Reserve for Replacement (R4R) Account

- A. **Introduction and Applicability.**

The Regulatory Agreement for projects financed with FHA-insured mortgages provides that the Borrower must establish and maintain an account to help defray the costs of replacing a project's capital items (the "Reserve for Replacement Account" or "R4R Account"). The R4R Account is held as a separate account with the Lender or in a safe and responsible depository designated by the Lender. Initial deposits to the account are to be made in cash at the time of the loan closing. The Borrower is required to begin making monthly deposits into the R4R Account on the date that the Borrower begins making payments to amortize the principal of the FHA-insured mortgage, or on such other date as may be approved by ORCF in writing. The monthly amount to be deposited in the R4R Account is set forth in the Regulatory Agreement which provides that the account is under the control of the Lender.

Disbursements from the R4R Account, whether for the purpose of effecting replacement of structural elements or mechanical equipment of a project; to cure a mortgage default; or for any other approved purpose, may be made only with the prior written consent of ORCF (or under the provisions whereby HUD allows Servicers to review R4R releases outlined in this chapter). For HUD-held mortgages, the Secretary will exercise control over the R4R Account pursuant to the authority granted under the National Housing Act. The following are some of the key requirements for a R4R Account:

1. Separate Account. The A R4R Account must be maintained as a separate account. The funds in the R4R Account may not be combined or commingled with other escrow accounts, including but not limited to, the accounts listed in Section 3.2.1 above, without the prior written approval of ORCF.
2. Interest Earned on Account. ORCF encourages and in some cases requires that interest earned on the R4R Account remain in the account. Interest may never be disbursed directly to the Borrower of a project or directly to any individuals associated with the Borrower (except for approved releases pursuant to 3.2.2.H of this Chapter). All interest earned must flow through the accounts of the project and must be disclosed on the project's accounting records.
- ~~2.3.~~ Insured Mortgagee Charges for Handling Investments of the reserve fund. If a Servicer proposes to assess charges for investing the reserve fund, the fees or charges for making or accepting investments must be set forth in an agreement between the Servicer and the Borrower, and may only be collected according to said agreement.
4. Type of Account. Funds in the R4R Account and all Escrow Accounts must be invested in (a) an interest-bearing account insured or guaranteed by the Federal Deposit Insurance Corporation, National Credit Union Association, or any United States of America insurance program, or (b) obligations of the Federal Government, including money market or other fund accounts limited to investments in such obligations. All funds, whether in the form of a cash deposit or invested in obligations of, or fully guaranteed as to principal by, the United States of America shall at all times be under the control of the Servicer. ORCF is not establishing specific liquidity requirements for the R4R Account. The Borrower, not the Servicer, is responsible for

deciding the liquidity requirements of funds held in the R4R Account. The Borrower should maintain some portion of its reserves in the form of very liquid assets such as passbook savings accounts. As a guideline only, and depending on the specific project, \$1,000/unit should be enough to meet minimum liquidity requirements for some projects.

NOTE: ALL MORTGAGORS SHOULD BE CAUTIONED. If any principal is lost as a result of an early or premature liquidation of an investment that is caused by an owner's requested withdrawal from the R4R Account, the lost principal must be repaid to the project. This repayment must be repaid to the project (Borrower entity) by the owning persons, come from non-project funds and be made by the persons who own the borrower entity, by persons with a controlling interest in the project, or by such affiliated/related parties as the project's sponsors. This caution is particularly important for non-profit mortgagors. Accordingly, the terms and durations of investments should be selected prudently and with great care.

3.5. Regulatory Agreement Not Modified. Nothing contained in this Section 3.2 shall be deemed to modify the terms and conditions of the Regulatory Agreement.

B. Realty vs. Non-Realty (a.k.a. Major Movable) vs. Realty Reserve for Replacement R4R Funds.

ORCF no longer recommends that FHA-insured projects maintain two R4R accounts (~~major-movables and~~ realty ~~and non-realty~~). If the project has two R4R Accounts, the Lender, with consent of the Borrower, may combine the two accounts into one account.

C. Qualified Repair or Replacement Expenses.

The purpose of the R4R Account is not to provide for a dollar for dollar ability to replace all building structural components and equipment as they wear out, but rather to provide a readily available source of capital to help defray the cost of replacing building structural components and equipment in the latter years of the project. The R4R Account shall not be considered as the primary source of funds for capital project repairs and replacements, but only as a supplemental source of funds. Borrowers should also maintain a repair, maintenance and/or replacement fund in the annual operating budgets of Section 232 FHA-insured projects. ~~The R4R account is also not for routine maintenance.~~ The following are eligible uses ("Qualified Expenses") for the R4R Account (~~the "Qualified Expenses"~~):

1. Capital items including, but not limited to:
 - a. Replacement of windows in the project.
 - b. Extensive replacement of kitchen and bathroom sinks and counter tops, bathroom tubs, water closets, and doors (exterior and interior).
 - c. Major roof repairs, including major replacements of gutters, downspouts, and related eaves or soffits.
 - d. Major plumbing and sanitary system repairs.

- e. Replacement or major overhaul of central air conditioning and heating systems, including cooling towers, water chilling units, furnaces, stokers, boilers, and fuel storage tanks.
- f. Overhaul of elevator systems.
- g. Major repaving/resurfacing/seal coating of sidewalks, parking lots, and driveways of the project.
- h. Repainting of the entire building exterior. Major painting of interior spaces, such as all common areas being repainted at one time, may be considered eligible. (Re-painting of individual rooms is considered routine maintenance, and not eligible.)
- i. Extensive replacement of siding.
- j. Extensive replacement of exterior (lawn) sprinkler systems.
- k. Major carpet replacement (e.g. multiple room replacements or entire common area of a project).

Generally, the following items ~~(previously categorized as major movables)~~ are Qualified Expenses, provided that ~~the price of an item is not less than \$500.00 each, and they are~~ not a routine maintenance item: office/common area/unit equipment, appliances and furniture, nursing/patient care equipment, food service/laundry/housekeeping equipment and appliances, and maintenance equipment. ~~The \$500.00 minimum may be waived if the scope of the replacement is considered to be extensive and replacement is done during the same time period—e.g. replacement of twenty refrigerators that are less than \$500 each.~~

2. For certain projects, capital improvements or enhancements to the project may be considered as a Qualified Expense. For example, individual air conditioning units may be added to a project that was not air conditioned when it was built; gutters and downspouts may be added where necessary; or an initial purchase of a ~~personal or office~~ computer and some associated software may be purchased. However, routine repairs, maintenance and service fees, such as internet fees, web hosting, software-hardware maintenance/updates, proprietary software/vendor fees and related expenses are not Qualified Expenses.

Some improvements may be eligible if ~~in the AE's judgment, the improvements~~ would they can be justified to:

- a. result in enhancing the mortgage security, including making the project energy efficient,
- b. upgrade the project and place the project in a more favorable competitive position in the marketplace,
- c. be necessary to comply with changes in local, state or Federal laws, and/or
- ~~d. not inordinately deplete the R4R Account.~~

B.D. Non-qualified Expenses: Items traditionally contemplated as ineligible expenses that may not be paid for with funds from the R4R Account include, but are not limited to the following maintenance items:

1. Repainting of interior areas of projects, including but not limited to, painting of residential units, hallways, community rooms, kitchens, offices, ~~etc. and the like.~~ A separate interior painting reserve for this kind of work may be established by mutual agreement and consent of the Borrower, Lender and ORCF. ~~ORCF may consider releasing funds for interior painting when: (i) the project does not have sufficient operating funds to cover such expense; and (ii) the interior painting is major work, involving at least two (2) or more rooms (including common or residential areas).~~
2. Replacement or repairs of a part or a component of range burners, televisions, computers, routers, bibs, oven elements, controls, refrigerators, valves, wiring, ~~etc. and the like.~~
3. Minor Replacements of dwelling unit air conditioning components such as fan motors and window unit compressors.
4. Minor repairs to central air conditioning and heating systems such as valve replacements and the cleaning of boiler interiors.
5. Minor roof repairs, including minor repairs to gutters and downspouts.
6. Minor paving or repairs.
7. Minor Caulking and sealing. However, caulking or sealing of the entire project to improve energy efficiency is a Qualified Expense.
8. Window and screen repairs.
9. Purchase of minor equipment, furniture, appliances or fixtures; ~~that is, items costing less than \$500.00—see Section 3.2.2.C.1.k, above, or the purchase of maintenance tools and equipment, such as lawn mowers or snow blowers.~~
10. Inspection/recharging/replacement of fire extinguishers.
11. Minor carpet or flooring repairs. However, carpet or flooring replacement of ~~two or more units~~ multiple areas/units or the entire common area of a project is a Qualified Expense.

E. Adequacy of Reserve for Replacement Account.

The Borrower must analyze the amounts in a project's R4R Account in the light of anticipated replacement needs (in certain cases ORCF may require that the Borrower perform an analysis of the account). A Borrower shall rely on its knowledge of the physical condition of the project, evaluations made by Operators or Management Agents, and physical inspection reports furnished by the Lender and by ORCF. If the Borrower's analysis indicates that it is necessary to increase the rate of deposits into the R4R Account, the

Borrower should contact the Lender to request authorization to increase the monthly deposit requirement.

F. Recommended Minimum Threshold.

Borrowers should strive to maintain a minimum recommended threshold equal to at least \$1000 per unit in the R4R Account. For example, the minimum R4R Account balance for a 100-unit project is \$100,000. The purpose of the minimum threshold is to ensure that funds are available for an emergency, such as a major roof failure or a water or sewer main break. Failure to maintain the minimum threshold could trigger a discussion by the AE with the Lender, and the Borrower to determine whether an increase in the deposit amount is appropriate given the reliance on the fund. If the account regularly falls below the recommended minimum, ORCF may decline to approve a request to withdraw funds from the R4R Account unless in an emergency situation.

G. Adjustments to Recommended Minimum Threshold.

The Borrower, Lender or ORCF may increase the recommended minimum threshold of \$1000 per unit under one or more of the following circumstances:

1. Physical Condition. Projects in ~~less than very good~~poor physical condition, as evidenced by a recent REAC Physical Inspection Score under 60, may require larger balances.
2. Geographical Location. Exposure to severe or unusual weather conditions, as well as the widely varying costs of repairs and replacements.
3. Immediate Replacement Needs. The project is in good physical condition but an unexpected large capital need arises.
4. Changes in Replacement Items. If non-traditional items, ~~such as routine carpet replacement,~~ are to become eligible R4R Account items, the minimum to be held in the account may need to be increased.
5. ~~Unit Composition. Projects with more larger-sized units typically require larger amounts in the R4R Account than projects with smaller units. For example, a project designed with more than one bed per housing unit would almost always require more reserves than a project with one bed per housing unit.~~
6. ~~Urban vs. Rural. Urban projects often require larger reserves than rural projects.~~

~~C. Three-Bid Requirements: If a single Qualified Expense or contract to repair or replace an item is in excess of \$50,000, the Borrower is required to obtain three (3) bids or price quotes and must comply with the following:~~

- ~~1. Three (3) bids must be secured and a confirmation that bids were obtained from qualified independent bidders must be provided to ORCF and the Lender. Actual~~

bids do not need to be submitted with a request to withdraw funds from the R4R Account, unless requested by ORCF or the Lender. However, the names of the bidders and the corresponding amount of each bid must be provided to the Lender and ORCF along with the name of the selected bidder or vendor (the "Bidder"). The Borrower must keep copies of all the bids on file for at least three years (3) from the date of receipt and make them available for ORCF staff to review. All Bidders (vendors, contractors or the like) must have all the appropriate credentials and applicable licenses, as are required by the local jurisdiction, to transact or conduct the business required by the bid.

2. If the lowest bidder was not selected, the Borrower must explain the reason for selecting the Bidder. For example, consideration may be given to the Bidder's reputation for quality workmanship, materials, and timely performance and to the urgency of the repairs.
3. If a portion of the funds are due in advance of the work that is to be performed by the Bidder, a request to withdraw funds from the R4R Account must be submitted as set forth in Section 3.2.2 above, along with documentation, such as a copy of the executed contract, invoice or purchase order, to support the amount being requested in advance. The Borrower must also explain why an advance is needed. At the discretion of ORCF, the request may be granted on an installment basis depending largely upon: the scope of work completed; the remaining work to be performed; the availability of funds in the project's operating account; and what is provided for in the contract, invoice or purchase order with the Bidder.
4. Failure to follow the bid requirements may result in ORCF's denial of the request to withdraw funds from the R4R Account. However, if the work commenced or was completed without three (3) bids and without the prior approval of ORCF, ORCF may still consider approving a request to use funds from the R4R Account if: (a) the work was performed in good faith; (b) the Borrower provides a certification that any future work over \$50,000 will be submitted for bid; (c) the costs or expenses for the work was reasonable for the area in which the project is located.
5. On a case by case basis, ORCF may waive the requirement to obtain bids for Qualified Expenses in certain circumstances. For example, ORCF may waive the bidding requirement: in cases of an emergency; where there is a lack of available vendors/bidders in the area that the project is located; or due to the very special nature of the Qualified Expense. Contact your AE for a waiver of the bid requirements.

D.H. Withdrawals from the Reserve for Replacement Account

1. Borrowers or Operators are to submit Reserve for Replacement (R4R) requests to **HUD-ORCF** through their Servicer (with the exception of those that can be directly reviewed and approved by the Servicer, as described in Section 3.2.2.H.5). A

checklist of required exhibits to submit ~~to HUD~~ for R4R requests will be available on the Section 232 Program website.

2. The Servicer is to receive the R4R requests, review them for completeness, accuracy and eligibility, and then forward them to HUD-ORCF with a recommendation for approval (with the exception of those that can be directly reviewed and approved by the Servicer, as described in Section 3.2.2.H-I, 5).

3. Typically, R4R releases are made for reimbursement on work that is completed. However, advances may be approved in situations where upfront or partial payments to the contractor(s) are required prior to the work being completed. At the Lender/Servicer's discretion, the R4R may be used to allow for multiple draws or a single draw, depending on the scope of work. For example, draws may be established at 35 percent, 65 percent and 100 percent completion for more substantive repairs.

~~2.~~

~~3.4.~~**Additional Considerations.** The following factors will be considered by HUD ORCF in processing a request to withdraw funds from the R4R Account ~~(or any other Escrow Account listed in this chapter):~~

- a. Whether the expense is a Qualified Expense, as defined in Section 3.2.2.C, or with respect to other Escrow Accounts, whether the expense is an eligible expense under the applicable account.
- b. Adequacy of the funds in the R4R Account.
- c. ~~Bid requirements as described in this Section 3.2.2.H, if applicable.~~
- ~~d. c.~~ If the project has an active or pending refinancing/financing application (i.e., 223(a)(7) or other loan program), the Borrower must disclose this information ~~to HUD~~ with the request to withdraw funds from the R4R Account.
- d. If the submittal proposes remodeling, adding to, subtracting from, reconstructing, or demolishing a portion of the mortgaged project (as discussed further in Section 3.4.4 of this chapter), an environmental review as required by 24 CFR Part 50 will be conducted ~~in accordance with Production, Chapter 7.~~
- e. Timing. It is recommended that requests for withdrawals be made not more often than quarterly. Additionally, requests for withdrawals shall be made no more than one year after the expenditure occurred.
- f. Invoices. Copies of invoices are not required to be submitted to ORCF if the description of the work done or items replaced is sufficiently detailed to permit an inspection and verification; however, the Borrower must keep copies of the invoices on file for at least three years and have the invoices available for ORCF staff to review

~~4. HUD Processing Format.~~ ORCF recommends that the request to withdraw funds from the R4R Account be submitted via electronic mail in PDF format or as a MS Word File.

744
745 5. **Optional Lender/Servicer Review and Delegated Approval of R4R Requests:**

746 In an effort to streamline operations, ~~de~~increase response times, and allow HUD
747 ORCF staff to focus on more complex R4R or escrow review requests, there are
748 certain requests that may be approved by the Servicer, as long as the ~~below~~ criteria
749 below are met. ~~Pre-approvals, advances, shortfalls, mortgage payments, etc. Special~~
750 Requests (see Section 3.2.2.I below) must ~~all~~ be submitted to ~~HUD-ORCF~~ for
751 processing and approved only by the AE, and are not eligible for Lender approval.
752

753 This Lender/Servicer review and delegated approval is not a requirement and is
754 optional for those who agree to administer the review and approvals within the HUD
755 and Section 232 guidelines.
756

- 757 a. **Lender Approval Process.** A prerequisite for participation in this process is
758 HUD approval of the Servicing Lender to participate in this delegated review.
759 If a Servicing Lender has been approved by Multifamily Housing in
760 accordance with their process related to delegated review of R4R requests,
761 ORCF shall consider the Lender approved to perform delegated review of
762 R4R requests for all residential care facility loan types (provided the specifics
763 of the transaction meets the below criteria). If a Servicing Lender wishes to
764 apply for approval solely to administer R4R Requests on Section 232 projects,
765 the request must be submitted electronically to the ~~ORCF-HUD~~ (see
766 procedures available on the Section 232 website) ~~Director of Asset~~
767 Management ~~LeanThinking@hud.gov email~~. The request must include a
768 revised Quality Control Plan addressing the items in 5.b through f below.
769 ~~HUD-ORCF~~ will retain responsibility for review of R4R requests in all cases
770 where there is an identity of interest between the Borrower, the Lender, or
771 affiliates of either.

- 772 b. Lender Delegated Authority is revoked if the project is serviced by ORCF's
773 Risk Mitigation Branch.

- 774 ~~b.c.~~ Typically, R4R releases are made for reimbursement on work that is
775 completed. However, advances may be approved in situations where upfront
776 or partial payments to the contractor(s) are required prior to the work being
777 completed. The request may only be for reimbursement requests on eligible
778 replacement items that have already been funded by the participant. At the
779 Lender/Servicer's discretion, the R4R may be used to allow for multiple
780 draws or a single draw, depending on the scope of work. For example, draws
781 may be established at 35 percent, 65 percent and 100 percent completion for
782 more substantive repairs.

- 783 ~~c.d.~~ The R4R account balance must be at a minimum level of \$1,000 ~~1,500~~ per
784 unit after the release.

- 785 ~~d.e.~~ If the R4R request is for a situation where there is a proposed remodeling,
786 adding to, subtracting from, reconstructing, or demolishing of a portion of the
787 mortgaged project (as discussed further in Section 3.4.4 of this Handbook),
788 the R4R request is not eligible for this optional Lender review. Such

proposals must be submitted to HUD-ORCF for routine processing and approval led only by HUD.

~~e.f.~~ All submitted reimbursement items must be Only qualifying expenditures, as defined in Section 3.2.2.C above, and as eligible and reported on the Funds Authorization (Form HUD-9250-ORCF) and Borrower Certification and Request Detail (Form HUD-9250A-ORCF) may be submitted for reimbursement.

~~f.g.~~ Servicer will review the request, and determine eligibility, and may approve qualifying requests (as described above) by signing the form, noting their Name (also to include Title and Organization), Signature, City, State, and Date in the respective fields.

~~g.h.~~ Once completed, all Funds Authorizations signed by the Servicer must then be submitted electronically to the AE for their files, as well as entry into the HUD system. This must be received by the AE, within seven (7) business days of Servicer approval.

~~h.i.~~ ORCF will not surcharge or penalize Servicers for approved R4R releases, provided the instructions in this handbook, and on designated HUD forms were followed.

E.I. Special Requests.

1. Request to suspend or reduce monthly deposits into the R4R Account. Generally a request to suspend or reduce monthly deposits will be considered only when the project is in good financial, physical and regulatory standing. The R4R Account balance must be equal to at least sixty (60) months of deposits. Monthly deposits cannot be suspended for more than 12 months at a time. The following items are required to be submitted to ORCF in connection with a request to suspend or reduce monthly deposits into the R4R Account:

- a. Completed Funds Authorization;
- b. Completed Borrower Certification and Request Detail;

If the request for suspension or reduction in the monthly R4R deposit is being requested because a project cannot currently fund the deposit, the Servicer and AE will conduct a meeting to discuss the financial situation, cash flow problems and any other concerns leading to this request from the project.

2. Borrowing funds to cover mortgage payments or operating deficits. In extreme cases, ORCF may consider a Borrower's request for a short term loan of funds from the R4R Account. The purpose should be related to a condition or circumstance beyond the normal control of the Borrower. A request for a loan from the R4R Account may trigger an enhanced analysis of the project. The following items are required to be submitted to ORCF in connection with a request for a short term loan of funds from the R4R Account:
- a. Narrative explaining the proposed loan terms, expenses to be paid and the reason for the request (including an explanation of any outstanding ORCF and state compliance issues);

- b. Completed Funds Authorization;
- c. Completed Borrower Certification and Request Detail;
- d. The three (3) most recent monthly financial statements for the project.

All Special Requests are to be submitted via the Servicer, who must first review them for completeness, accuracy and eligibility, and then forward them to ORCF with a recommendation for approval.

3.2.3

Residual Receipts Account

A. Definition.:

During the life of an FHA insured mortgage, Residual Receipts are an asset of the Borrower held under the control of ORCF. If a Borrower is required to establish a Residual Receipts Account for a project, the requirement will be set forth in the Regulatory Agreement which will set forth the type of assets that are included in the definition of "Residual Receipts."

B. Calculation of Residual Receipts.:

The Borrower should use Form HUD-93486 -ORCF Computation of Surplus Cash, Distributions, and Residual Receipts either semi-annually or annually (depending on the Regulatory Agreement for the project) to calculate allowable distributions and any amounts that may be due for deposit in the Residual Receipts Account. Instructions for completing the form are shown on the back of the form and the calculation for distributions must be included in the audited annual financial statements filed with HUD.

C. Depositing Residual Receipts.:

Residual Receipts must be deposited in a separate Residual Receipts Account, except to the extent that the Non-profit Borrower's Regulatory Agreement may provide some limited right to retain Residual Receipts. Funds in the Residual Receipts Account may not be combined or commingled with other escrow accounts, including, but not limited to, the accounts listed in Section 3.2.1 above, without the prior written approval of ORCF. The Regulatory Agreement specifies when Residual Receipts are to be deposited into the Residual Receipts Account. The account is must be maintained with by the Lender.

D. Holding and Investing Funds.:

Funds in the Residual Receipts Account for all projects with FHA-insured mortgages must be invested in, and all interest earned on the investments must be credited to, the Residual Receipts Account a financial vehicle that meets HUD approval. Funds in Residual Receipts Account are to be invested and safeguarded by Lenders and Borrowers in the manner described in Section 3.2.2 of this chapter.

E. Qualified Uses for the Residual Receipts Account.:

Borrowers may request disbursement of funds from the Residual Receipts Account for the following purposes:

1. To reduce operating deficits when legitimate cash flow deficits exist.
2. To make mortgage payments when a mortgage default has occurred or is imminent.
3. To make repairs or replacements to the project that are not covered by the R4R Account described in Section 3.2.2 above.
4. To provide additional project amenities such as air conditioning, a sprinkler system, fire or smoke detectors, or energy saving devices as well as office equipment such as computers and associated software.
5. For other expenses deemed necessary, and in the best interest of the project as determined by ORCF and the Lender. Generally, all expenses which qualify for reimbursement under the R4R Account may also be reimbursed from funds in the Residual Receipts Account.

A.F. Withdrawals from the Residual Receipts Account.

The Lender must submit the following:

1. Required Documents. A checklist of required exhibits to submit to ~~HUD-ORCF~~ for withdrawals from the Residual Receipts Account will be available on the Section 232 Program website. Requests are to be submitted via the Servicer, who must first review them for completeness, accuracy and eligibility, and then forward them to ORCF with a recommendation for approval.
2. Additional Considerations. The following issues will be considered by ORCF in processing a request to withdraw funds from the Residual Receipts Account:
 - a. Whether the expenses are qualified items to be paid from the account.
 - ~~b. Bid Requirements, if applicable (See the requirements set forth in Section 3.2, H of this chapter).~~
 - ~~c. b.~~ If the submittal proposes remodeling, adding to, subtracting from, reconstructing, or demolishing a portion of the mortgaged project (as discussed further in Section 3.4.4 of this chapter), an environmental review as required by 24 CFR Part 50 will be conducted ~~in accordance with Production, Chapter 7.~~

~~**B. Processing Format.** ORCF recommends that requests to withdraw funds from the Residual Receipts Account be submitted electronically in PDF format or as a MS Word File.~~

3.2.4

Non-Critical Repair Escrow Account (NCRE)

- 920 A. **Applicability:** Non-Critical Repair Escrow (“NCRE”) Accounts are established during the
921 underwriting of a project and funded at Closing. The funds in the NCRE Account are
922 intended to pay for repairs identified in the Escrow Agreement for Non-Critical Repairs (the
923 “NCRE Agreement”). ~~Normally~~Generally, the repairs must be completed within 12 months
924 from the date of the NCRE Agreement. The specific requirements and conditions for the
925 completion of the repairs are set forth in ~~said the NCRE a~~the NCRE agreement.
926
- 927 B. **Depositing, Holding and Investing:** Funds in the NCRE Account must also be deposited,
928 held and invested in accordance with the requirements set forth in Section 3.2.2 of this
929 chapter. However, since the funds are intended to be disbursed within a 12 month period,
930 they must be deposited in an account that can be withdrawn from or immediately accessed in
931 the full amount. Depositing NCRE Account funds in a long-term investment account is not
932 recommended.
933
- 934 C. ~~Interim Withdrawals~~ Draws and Closeout off ~~from~~ the NCRE Account ~~(except in~~
935 ~~connection with a final or close-out request)~~
936 1. Interim Draws: At the Lender/Servicer’s option, the NCRE Account may be
937 established to allow for multiple draws or a single draw, depending on the scope of
938 work. For example, draws may be established at 35 percent, 65 percent and 100
939 percent completion for more substantive repairs.
940
941 2. Holdback/Retainage: HUD does not require a holdback/retainage on interim draw
942 releases, however, the lender may require a holdback/retainage at their discretion.
943
944 3. Advances: Typically, draws are approved for reimbursement on work that is
945 completed. However, advances may be approved in situations where upfront or
946 partial payments to the contractor(s) are required prior to the work being completed.
947
948 4. Review of Proposed Draws and Closeout: When determining whether to approve a
949 proposed interim draw or final draw (closeout) of the NCRE, the Lender/Servicer
950 shall review the submission from the borrower to determine whether there is
951 adequate documentation to evidence that the repairs/improvements associated with
952 the requested release were completed (or there is evidence that an advance is
953 required per Section 3.2.4.C.3. above). With the exception of NCRE accounts
954 administered by Lenders/Servicers under Section 3.2.4.H, the requests are to be
955 submitted via the Servicer, who must first review them for completeness, accuracy
956 and eligibility, and then forward them to ORCF with a recommendation for approval
957 (submitted electronically in accordance with the instructions on the Section 232
958 program website). A checklist of documents for review will be available on the
959 Section 232 Program website.
960
- 961 D. **Latent Defects Deposit.** A Latent Defects Deposit is required when the total cost of the
962 non-critical repairs is equal to or exceeds \$1,000,000. The Latent Defects Deposit is
963 calculated at 2.5% of total amount of repairs and is held by the lender to be released to the

borrower upon the later of : (i) 15 months from the completion of repair work, or (ii) at such time the latent defects have been corrected to the satisfaction of ORCF.

E. Change of Scope of Repairs. The Lender/Servicer must request approval of ORCF for proposed revisions to the scope of the required repairs/improvements (submitted electronically by the Lender/Servicer, in accordance with the instructions on the Section 232 program website). For such a request, the following must be submitted:

1. A narrative detailing why a change of scope is requested; or the reason that some or all of the non-critical repairs were not completed, as applicable.
2. Copy of the original NCRE Agreement.
3. Certification from an individual determined to be qualified by the lender (e.g. PCNA provider, lender construction analyst, architect, engineer). The certification must provide that: failure to complete the non-critical repairs will have no serious negative impact on the condition of the project; and the project, as completed, is in compliance with local building and zoning codes, and/or state regulations.

F. Timing of Completion of Repairs and Extensions – All repairs must be completed within the 12 month prescribed time period, unless otherwise provided in the NCRE Agreement. The Lender/Servicer may provide a six month extension at their discretion without ORCF approval where the borrower demonstrates adequate justification. Notification of the six month extension must be submitted to ORCF (see procedures available on the Section 232 website). Any extension beyond six months requires Lender/Servicer review and recommendation to ORCF for approval (submitted electronically by the Lender/Servicer, in accordance with the instructions on the Section 232 program website). Under no circumstances may an extension beyond 12 months be made for repairs necessary to correct accessibility deficiencies. All such repairs must be made within the time periods prescribed in the Accessibility Matrix for Section 232.

G. Excess Funds at Closeout - In cases where the actual cost of the repair work is less than estimated, any resulting excess funds in the escrow attributable to the Repair Estimate amount that were funded from loan proceeds may be used for the following purpose(s):

- a. to pay for additional repairs approved by Lender and ORCF,
- b. to reduce the outstanding Loan balance; or
- c. to deposit in the R4R.

ORCF may also require that certain repairs be completed when the specified repairs are deemed necessary for the proper operation of the facility, for resident care and/or if the repairs are needed to comply with local and state regulations.

1. Required Documents and Approval Authority. The Lender/Servicer must collect, review, and submit the following documents to HUD for review, accompanied by a recommendation of approval to be included in the email or fax submission:

- a. ~~Request for Approval of Advance/Release of Escrow Funds (Form HUD-92464-ORCF)~~
- b. ~~Borrower's Certification—Full or Partial Completion of Non-Critical Repairs (Form HUD-92117-ORCF)~~
- c. ~~Supporting documentation required by Borrower's Certification—Full or Partial Completion of Non-Critical Repairs.~~

2. ~~Review of Proposed Withdrawal. When determining whether to approve a proposed withdrawal, HUD shall review the documentation above to determine whether there is adequate documentation to evidence that the repairs/improvements (associated with the requested release) were completed.~~

~~D. Request to Close-Out the NCRE Account.~~

Required Documents. After all repairs have been completed, the Borrower may request that all funds remaining in the NCRE Account be released, including funds that have been withheld for repairs and latent defects, if applicable. The Borrower must submit the following documents to ORCF with a request to close-out the NCRE Account, along with a written statement of review of all documents, and recommendation for approval by the Lender:

1. ~~Request for Approval of Advance/Release of Escrow Funds.~~
2. ~~Borrower's Certification—Full or Partial Completion of Non-Critical Repairs form and supporting documentation required by the form.~~
3. ~~If provided in the NCRE Agreement, the Borrower must deposit with the Lender, an amount approved by said Lender to correct latent defects (the "Latent Defects Deposit"). A Latent Defects Deposit is required when the request to close the NCRE Account is less than 12 months from the date that the applicable repairs were completed. If the net total (or 100%) of the amount escrowed for repairs in an NCRE Account is less than \$100,000, the Borrower may request a waiver of the requirement to make a Latent Defects Deposit. The request for a waiver shall be submitted with the request to close-out the NCRE Account, either in a cover letter or via electronic mail to ORCF.~~
4. ~~Evidence of Clear Title.~~

~~E. Special Issues.~~

1. ~~Any proposed revision to the scope of the required repairs/improvements or request for an extension of the time to complete the repairs/improvements must be approved by the AE (submitted via email by the Lender). The following documents are required:~~

- 1053 a. ~~A narrative in the email request detailing why an extension is requested; or the~~
1054 ~~reason that some or all of the non-critical repairs were not completed, as~~
1055 ~~applicable.~~
1056 b. ~~Repairs that will not be completed on time or at all must be set forth on the~~
1057 ~~Request for Approval of Advance/Release of Escrow Funds form.~~
1058 c. ~~The certification must provide which repairs will not be completed on time or~~
1059 ~~at all (Borrower's Certification—Full or Partial Completion of Non-Critical~~
1060 ~~Repairs).~~
1061 d. ~~Copy of the original NCRE Agreement.~~
1062 e. ~~Certification from a licensed inspector, architect, engineer, or the PCNA~~
1063 ~~inspector. The certification must provide that: not completing the non-critical~~
1064 ~~repairs will have no serious negative impact on the condition of the project;~~
1065 ~~and the project, as completed, is in compliance with local building and zoning~~
1066 ~~codes, and/or state regulations.~~

1068 2. ~~After completion of all required repairs/improvements, any excess funds in the~~
1069 ~~Escrow attributable to the Repair Estimate Amount that were funded from Loan~~
1070 ~~proceeds may be used for the following purpose(s): (a) to pay for additional repairs~~
1071 ~~approved by Lender and AE, (b) to reduce the outstanding Loan balance; or (c) to~~
1072 ~~deposit in the R4R. ORCF may also require that certain repairs be completed when~~
1073 ~~the specified repairs are deemed necessary for the proper operation of the facility, for~~
1074 ~~resident care and/or if the repairs are needed to comply with local and state~~
1075 ~~regulations.~~

1077 ~~F. **Processing Format.** ORCF recommends that requests to withdraw funds from or to close~~
1078 ~~out the NCRE Account be submitted electronically in PDF format or as a MS Word File.~~

1080 ~~F.H.~~ **Optional Process for Delegated NCRE Administration to Lenders/Serviceers.**

1082 **1. Purpose and Background.**

1083 This optional process applies only to residential care facility transactions originated
1084 under Sections 223(f) and 223(a)(7). A prerequisite for participation is HUD
1085 approval of revisions to the Servicing Lender's Quality Control Plan incorporating
1086 the requirements of this Handbook.

1088 **2. Lender Approval Process**

1089 If a Servicing Lender is approved by Multifamily Housing in accordance with Notice
1090 H2013-14 for delegated NCRE administration, ORCF shall consider the Lender
1091 approved to perform delegated NCFE administration for the loan types referenced in
1092 the previous paragraph. If a Servicing Lender wishes to apply for approval solely to
1093 administer NCRE's on residential care facilities, the request must be submitted
1094 electronically to HUD (see procedures available on the Section 232 program
1095 website). the ORCF Director of Asset Management. The request must include a
1096 revised Quality Control Plan addressing the following items:

~~Procedures to ensure the work is completed within the Project Capital Needs Assessment (PCNA) scope of work, within budget, and on time.~~
~~Procedures to ensure completion of the Supplemental Cost Certification.~~
~~The identification of the staff assigned to oversee the escrow administration and a primary point of contact. The Lender staff approving draw requests must be an approved Construction Loan Administrator.~~

HUD-ORCF will retain responsibility for release of non-critical repair escrow funds in all cases where there is an identity of interest between the Borrower, the Lender, or affiliates of either.

Lender Delegated Authority is revoked if the project is serviced by ORCF's Risk Mitigation Branch.

3. **General Requirements.**

Should the Lender elect to take responsibility for this task (and receive HUD approval to do so), HUD will not charge an inspection fee on Section 232, pursuant to Section 223(f), transactions. Section 223(a)(7) transactions do not require an inspection fee. ORCF has not established a minimum or maximum repair/improvement amount on which this delegated process may be used.

This delegated authority allows the Servicing Lender to review and approve all interim draw requests ~~with the exception of~~ and the close-out of the account. ~~The close-out of the account is detailed in Section 3.2.4.D., above.~~ Under this delegated authority, the request to close-out the account must include a report from an individual determined to be qualified by the Lender (e.g. the PCNA provider, lender construction analyst, architect or engineer), who prepared the report at underwriting, indicating they have performed an inspection and all required repairs or improvements have been acceptably completed. No such inspection or report is required for interim draws; however, at the Lender's discretion, interim inspections may be conducted. ~~—see below discussion for the details on Lender processing and approval of interim draws.~~

~~The AE assigned to the project will be the Lender's point of contact throughout this process.~~

4. Interim Draws and Closeout of the NCRE Account, Latent Defects Deposit, and Change of Scope of Repairs shall be addressed in accordance with the provisions above in Section 3.2.4.C, D and E of this section.

5. Timing of Completion of Repairs and Extensions. All repairs must be completed within the 12 month prescribed time period, unless otherwise provided in the NCRE Agreement. The Lender/Servicer may provide a six month extension at their discretion without ORCF approval where the borrower demonstrates adequate justification. Any extension beyond six months requires Lender/Servicer review and

recommendation to ORCF for approval (submitted electronically by the Lender/Servicer, in accordance with the instructions on the Section 232 program website).

6. **Excess Funds at Closeout.** In cases where the actual cost of the repair work is less than estimated, any resulting excess funds in the escrow attributable to the Repair Estimate amount that were funded from loan proceeds may be used for the following purpose(s):

- a. to pay for additional repairs approved by Lender,
- b. to reduce the outstanding Loan balance; or
- c. to deposit in the R4R.

7. The Lender is delegated to approve the final close-out of the NCRE. The request to close-out the account shall follow the same procedure as outlined above.

8. If there is a Latent Defects Deposit remaining after the close-out of the account, such Latent Defects Deposit may be reviewed and released by the Lender after the required seasoning period has passed. No further documentation on this is required to be sent to ORCF.

9. Copies of the final fully executed HUD-92464-ORCF and HUD-92117-ORCF (without attachments) and final inspection report must be submitted electronically to ORCF within seven (7) business days of the Lender's final approval.

The Lender/Servicer must keep electronic or hard copies of the documentation related to any NCRE accounts administered by the Lender/Servicer under this delegated process for at least three years.

1. Processing Instructions.

i. The Lender's Firm Commitment application must specify that the Lender will assume noncritical repair escrow administration on that particular transaction. The fee to pay the PCNA provider for the inspection/report after the repairs/improvements are completed may be treated as an eligible mortgageable cost. The Firm Commitment will include a Special Condition acknowledging that the Lender has been approved to administer the NCRE.

b. The Lender may review and approve of all interim draw requests provided the scope of repairs/improvements is the same as those outlined in the Firm Commitment. If the scope deviates from that outlined in the Firm Commitment, the Lender must obtain the AE's approval of the revised scope (per Section 3.2.4.E.1. of this chapter) prior to moving forward with the approval of further draws.

c. Interim draw requests reviewed under this procedure shall follow the submittal documents and process outlined in Section 3.2.4.C above, with the

- exception that the Servicing Lender may approve the draw. Lender approval will be evidenced by signing on the Request for Approval Advance of Escrow Funds, including their Name, Title and Organization. After approving the draw, the Lender shall email the AE a copy of the signed Request for Approval of Advance/Release of Escrow Funds form (no further documentation on interim draws is required to be submitted to HUD).
- d. ~~The request to close out the account shall be submitted to the AE and shall follow the submittal documents as outlined in Section 3.2.4.D above; however, it shall also include the PCNA provider's report as discussed above. If there is a Latent Defects Deposit remaining after the close out of the account, such Latent Defects Deposit may be reviewed and released by the Lender after the required seasoning period has passed. No further documentation from HUD on this is required.~~
- e. ~~The Lender must advise the AE via email if it is expected the repairs/improvements will not be completed prior to the maximum time period set forth in the escrow agreement or if there are cost overruns that would jeopardize the ability to fund all required repairs/improvements with the amount of escrowed funds.~~

3.2.5

Sinking Fund

- A. **The Sinking Fund Agreement** is the controlling document for the Sinking Fund. The Sinking Fund Account must remain in compliance with the Sinking Fund Agreement. ORCF must be promptly notified by the Lender in the event of any breach ~~of by~~ the Borrower of the Sinking Fund Agreement and the Lender must further agree to seek specific performance or other injunctive relief for any breach.
- B. **Requests for Withdrawal from the Sinking Fund Account.** Withdrawals from the Sinking Fund Account may only be made for the specific purposes stated in the Sinking Fund Account Agreement. Requests are to be submitted via the Servicer, who must first review them for completeness, accuracy and eligibility, and then forward them to ORCF with a recommendation for approval. ~~The Borrower must submit the request to ORCF.~~ A checklist will be available on the Section 232 Program website.
- C. **Requests to close a Sinking Fund Account prior to expiration.** Normally/Generally a request to close the account prior to expiration of the mortgage is submitted when the state Medicaid provider, where the project is located, no longer requires the maintenance of a Sinking Fund Account, and the project is in good physical and financial condition. Since a Sinking Fund Account is beneficial to the interests of the Borrower, Lender and ~~the Secretary~~ HUD in the latter years of a mortgage, a state rule eliminating the Sinking Fund Account does not automatically modify or remove ~~the this~~ requirement for FHA-insured projects. Requests are to be submitted via the Servicer, who must first review them for completeness, accuracy and eligibility, and then forward them to ORCF with a recommendation for

approval. The Borrower must submit the request to ORCF. A checklist will be available on the Section 232 Program website.

3.2.6

Debt Service Escrow and Long-Term Debt Service Reserve Accounts

- A. **Applicability.** In specific instances, ORCF may have a Long-Term Debt Service Reserve account established at closing (See Production, Chapter 2). This account is a mortgageable item and is controlled by the terms of the Borrower Regulatory Agreement. This account is different from a Debt Service Escrow account, which is for a shorter term, is funded by the Borrower, and is governed by a separate escrow agreement. The Long-Term Debt Service Reserve Escrow Account, if required, is established during the underwriting of a project either at initial or final closing. Each of these accounts is intended to provide Borrowers with an extra "cushion" to meet debt service payments on the FHA-insured mortgage and thus, safeguard the project's financial viability. Funds in these accounts are to be used exclusively for payments of principal and interest on the Mortgage Note, or to meet project escrows such as insurance premiums, real estate taxes or special assessments.
- B. **Holding and Investing Funds.** Generally, the requirements of Debt Service Escrow Account are set forth in the Escrow Agreement, and the requirements of the Long-Term Debt Service Reserve Account are set forth in the Borrower Regulatory Agreement. The funds in these accounts are to be invested and safeguarded by Lenders and Borrowers in the manner described in Section 3.2.2 of this Handbook. The procedures and sanctions described in Section 3.2.2 also pertain to these accounts.
- C. **Request for Withdrawal:** Requests are to be submitted via the Servicer, who must first review them for completeness, accuracy and eligibility, and then forward them to ORCF with a recommendation for approval. The following documents are to be submitted when requesting funds from a Mortgage Reserve/Debt Service Reserve Account. A checklist will be available on the Section 232 Program website.

Required Documents:

Request for Approval of Advance of Escrow Funds. **Note:** On top left side of Page 1, Draw a line through "Advance Escrow Funds" (Strikethrough) and write in "Mortgage Reserve/Debt Service Reserve Account."

- Copy of Escrow Agreement and Schedule, if applicable.
- Copy of the mortgage statement, invoice, or a list of monthly mortgage payments to be paid by this request.
- Cash flow for month funds will be applied to mortgage payment
- Current financials for previous 12 months, by month.
- Bed/unit census for the previous 12 months, by month.
- Forecast bed/unit census for the next 12 months, by month.

- ~~Budget for the next 12 months, by month~~
- ~~Most recent State Survey/Inspection~~

SPECIAL NOTE: Any request deviating from the Mortgage Reserve/Debt Service Reserve Agreement, or any amendments and schedules thereto, shall be closely analyzed by ORCF. The approval will be conditioned with a full repayment of the funds to the account within a reasonable time frame.

D. **Additional Considerations.** The following issues will be considered by ORCF in processing Mortgage Reserve/Debt Service Reserve Account.

- Financial and Physical Condition of the Project.
- Open ORCF and State compliance Issues.
- Other relevant issues, information or documents as determined by ORCF.

~~E. **Processing Format:** ORCF recommends an electronic submission via email as PDF or MS Word File.~~

3.2.7

Initial Operating Deficit Escrow

A. **Applicability.** Initial Operating Deficit (IOD) Escrow Accounts are restricted accounts that are primarily designed to allow or assist the project ~~to in~~ achieving sustained occupancy and adequate revenue. Disbursements from the IOD Escrow Account may be authorized monthly by ORCF to meet any cash deficit in the operation of a project for the period immediately following substantial completion of construction. Requests are to be submitted via the Servicer, who must first review them for completeness, accuracy and eligibility, and then forward them to ORCF with a recommendation for approval.

B. **SPECIAL NOTE:** The IOD Escrow Account is a part of the pProject's necessary start-up working capital. ORCF does not consider depreciation, officers' salaries, and identity of interest management fees to be reasonable operating expenses; therefore, funds in the IOD Escrow Account may not be used cover those costs.

Section 3.3

Prepayment Provisions and Prohibitions

3.3.1

Introduction

Applicability. The Residential Care Facilities Program permits Lenders to insert prepayment lockouts and penalties into the FHA-insured Note for the benefit of the source of the financing in accordance with the guidelines set out in Production, Chapter 3. Prepayment request review procedures are as follows.

3.3.2

Prepayment Procedures

HUD must receive notification in writing from the Lender, requesting to prepay a loan insured by FHA (or voluntarily terminate its mortgage insurance). The Servicer is to receive the requests, review for completeness, accuracy and eligibility, and then forward to ORCF with a recommendation for approval.

The following are the steps for processing a request for prepayment of an FHA-insured mortgage or a voluntary termination of mortgage insurance:

A. Lender submits the Insurance Termination Request for Multifamily Mortgage form (Form HUD-9807) (without Block 5 completed) to the Multifamily Insurance Operations Branch in HUD Headquarters. That Office forwards a copy of the form and supporting documentation to the ORCF, which will verify that there are no prepayment restrictions for the particular project. In most cases, HUD Counsel review will not be required, but ORCF will coordinate as necessary.

B. The following must accompany the Insurance Termination Request for Multifamily Mortgage request from the Lender:

- Mortgage,
- Mortgage Note,
- Deed of Trust,
- Deed of Trust Note,
- Riders,
- Any Allonges or Amendments,
- Regulatory Agreement,

- Trust Indenture (if the Project is bond financed),
- Any secondary financing and status,
- Use restrictions, and
- Any special requests from the Lender or Borrower.

Review of the prepayment request by HUD cannot begin without the above information, along with the executed Insurance Termination Request for Multifamily Mortgage form. The complete submission of the documents is the responsibility of the Lender.

C. ORCF will ensure the following:

1. Determine if prepayment falls within any lockout period;
2. Determine status of any secondary financing and review the HUD asset management system (iREMS);
3. Determine any outstanding Departmental Enforcement Center (DEC) or Office of Inspector General (OIG) investigations, based on iREMS; if any exist, obtain input from the appropriate Division on prepayment approval.
4. Address any special requests the Lender may have prior to closing. Termination of the Borrower Regulatory Agreement would be deemed a special request, and would need to be prepared by HUD's Office of General Counsel.

D. The Office of Multifamily Insured Operation Branch will perform an audit of the loan(s) to calculate the estimation of payoff (based on projected closing date) and any refund due to the Project for overpayment of MIP, if applicable.

E. The Lender must ensure the Office of Multifamily Insured Operation Branch is notified of the closing date that is scheduled by the Project's counsel (and bond issuer, if applicable).

F. For closing and bond defeasance, the bond issuer defeases the bonds and sends HUD the complete Form 9807. Prior to closing the Lender must coordinate with the Multifamily Insured Operation Branch Chief to ensure timely processing of the Form 9807.

G. ORCF will reflect the prepayment once the Office of Multifamily Insured Operation Branch has confirmed that the payoff occurred. The ~~ORCF~~ AE must update iREMS to ensure the Project no longer is required to submit financial statements (if fully terminated from FHA-insurance) and document that the prepayment has occurred. Special care must be taken to ensure the Project is fully terminated from FHA-insurance prior to making updates to iREMS. For example, a refinance under Section 223(a)(7) involves a payoff of the existing loan, but the refinanced loan is still required to submit financial statements.

3.3.3

Prepayment Lock Outs and Penalties

A. Language allowing HUD to override the prepayment lockout and/or penalty provisions in the event of a default is included in the Healthcare Facility Note (Form HUD-94001 ORCF).

The Servicer is to receive the requests, review for completeness, accuracy and eligibility, and then forward to ORCF with a recommendation for approval.

A.B. Where these restrictions exist, and the Lender does not waive its optional prepayment or lockout penalty provisions, in rare circumstance HUD would consider exercising an override of a Lender's prepayment lock-out or penalty provision in order to avoid a full claim. Any override to the lockout must receive approval by the Deputy Assistant Secretary for ~~ORCF~~ ORCF OHP. Generally speaking, these projects will be in, or transferred to, the ~~ORCF~~ Risk Mitigation Branch portfolio due to the troubled nature of the project. As part of the workout necessary to avoid a claim, a background memo is prepared from the Risk Mitigation AE, explaining the circumstances justifying the request. Consideration must be given to all of the following, in providing such justification:

1. The Borrower has defaulted and HUD has received notice of such default as required by the regulations.
2. HUD determines that the project has been experiencing a net income deficiency that was not caused solely by management inadequacy or lack of Borrower interest and that is of such a magnitude that the Borrower is currently unable to make required debt service payments, pay all project operating expenses, and fund all required reserves.
3. HUD finds there is a reasonable likelihood that the Borrower can arrange to refinance the defaulted loan at a lower interest rate or otherwise reduce the debt service payments through partial prepayment.
4. HUD determines that refinancing the defaulted loan at a lower rate or partial prepayment is necessary to restore the project to a financially sound condition and to avoid an insurance claim.

~~B. If a Borrower desires HUD's override of the lockout, it must initiate the written request to ORCF.~~

C. ORCF must be satisfied that the Borrower in these circumstances did not intentionally cause a default in order to obviate prepayment penalties or lockout provisions.

Section 3.4

Request to Release or Modify Original Loan Collateral

3.4.1

Introduction

- A. From time to time the collateral securing a FHA-insured mortgage needs to be modified or released. The Regulatory Agreement provides language requiring prior HUD approval of a revision to the security or collateral, including the following:
1. Reduction, Addition, or Sale of Beds (Please refer to 3.4.2 below)
 2. Easements, Eminent Domain, or Sale of Land or Other Security (Please refer to 3.4.3 below)
 3. Remodeling, Adding to, Subtracting From, Reconstructing, or Demolishing Portions of the Mortgaged Project (Please refer to 3.4.4 below)
- B. A checklist of required exhibits to submit to HUD in each situation will be available on the Section 232 Program website.

3.4.2

Reduction, Addition, or Sale of Beds

- A. **Applicability:** Licensed beds are valuable project assets securing the mortgage. Any time the number of licensed beds in the project are being reduced or increased, the value of the mortgaged project may be affected.
- B. **Additional Considerations:** The following issues will be considered by ORCF in processing a Reduction or Increase of number of beds:
1. Financial and Physical Condition of the Project.
 2. Open HUD and State Compliance Issues.
 3. Project's PCNA (Physical Condition and Needs Assessment). If PCNA is ~~more~~ more than 10 years old, ORCF may require a new PCNA to be performed.
 4. The value of the remaining project after approval will be unaffected or the value will still be sufficient to cover the remaining balance of the mortgage.

5. Other relevant issues, information or documents as determined by ORCF.
6. ORCF will engage the services of HUD OGC (and as needed, OHP Architecture & Engineering, and/or Appraisal teams) to review all legal and technical issues.
7. In processing release of collateral requests in which funds are being received for the sale of beds, ORCF will expect to receive market value for the released collateral and the funds will be directly applied to the mortgage balance. Any deviation from this must be expressly approved by ORCF.

C. **Processing Time.** The concurrent reviews by HUD OGC and OHP Architecture & Engineering, if required, will affect the length of processing time.

D. **Other ORCF Requirements.** It should be noted that in all increase or reduction of licensed bed requests, ORCF may require or request additional relevant documents or information. The Servicer is to receive the requests, review for completeness, accuracy and eligibility, and then forward to ORCF with a recommendation for approval.

3.4.3

Easement, Eminent Domain, or Sale of Land or Other Security

A. **Applicability.** The Regulatory Agreement provides that the Borrower shall not, without the prior written approval of HUD, convey, transfer, or encumber any of the mortgaged project. Generally, there are two types of partial release of security requests. Negotiated release is when the transaction is voluntarily negotiated between the parties. Involuntary or eminent domain action is when a local or State agency exercises its function to use a project asset for public use. In both situations, the project must be compensated for the asset appropriated or affected (Please see Section 232 Program website). The Servicer is to receive the requests, review for completeness, accuracy and eligibility, and then forward to ORCF with a recommendation for approval.

B. **Negotiated or Voluntary Partial Release of Security.** This can include the sale of a portion of project land, part of a building, major assets, etc. Note: Although Easements and Right of Ways are not technically a release of security, the approval requirement in this sub-chapter will be applicable. Normally, ORCF will consider approving such requests when:

1. The quiet enjoyment of the present tenancy will not be negatively affected.
2. The amount of the reimbursement (or sale) is greater than or equal to the ORCF-determined value of the severed portion at the time of severance.

3. The value of the project will be unaffected by the partial release of security or the value will increase as a result of it.
4. The terms of the sale are cash.
5. The security to be released is not in place to mitigate an environmental condition on the site.

C. **Additional Considerations.** The following issues will be considered by ORCF in processing a Partial Release of Security request:

1. Financial and Physical Conditions of the Project.
2. Open HUD and State compliance Issues.
3. Project's PCNA (Physical Condition and Needs Assessment). If PCNA is more than 10 years old, ORCF may require a new PCNA to be performed.
4. The value of the remaining project after approval will be unaffected by the partial release of security or the value will still be sufficient to cover the remaining balance of the mortgage.
5. Other relevant issues, information or documents as determined by ORCF.
6. ORCF may also engage the services of the HUD OGC, the OHP Architecture & Engineering, and/or Appraisal teams to review all legal and technical issues.
7. If Ginnie Mae securities are involved, the Lender must ensure compliance with Ginnie Mae.
8. In processing Partial Release of Security requests in which funds are being received, ORCF will expect to receive market value for the released collateral and the funds will be directly applied to the mortgage balance. Any deviation from this must be expressly approved by ORCF.

D. **Processing Time.** The concurrent reviews by HUD OGC and OHP Architecture and Engineering, if required, will affect the length of processing time.

E. **Involuntary or Eminent Domain Partial Release of Security.** As soon as an involuntary partial release is known, the Borrower, Operator, Management Agent and/or Lender shall immediately notify ORCF. A copy of all received notices, documents, plans, proposals, or documents related to the proceeding, shall immediately be given or forwarded to ORCF. Urgency is required, because when a portion of the mortgaged project is taken by a public authority through the use of condemnation proceedings, such taking can be without the prior approval of either the Lender or ORCF.

If ORCF's field review indicates that the proposed condemnation has the potential to cause default of the mortgage or negatively impact on the quiet enjoyment of the intended purpose, as early as possible in the process, ORCF field staff must consult with the Director, Asset Management and Lender Relations immediately.

3.4.4

Remodeling, Adding to, Subtracting ~~f~~From, Reconstructing, or Demolishing Portions of the Mortgaged Project

- A. **Applicability.** The various forms of Borrower and/or Operator Regulatory Agreements existing on residential care facility projects require written approval from HUD prior to remodeling, adding to, subtracting from, reconstructing, or demolishing a portion of the mortgaged project. The Servicer is to receive the requests, review for completeness, accuracy and eligibility, and then forward to ORCF with a recommendation for approval. “Remodeling” for purposes of this Section is defined as repairs/improvements that constitute “Substantial Rehabilitation” – as defined in the Production, Chapter 2.6.B. This chapter provides instructions on submitting a request for partial release of security from the insured mortgage. (See Section 3.4.3 of this chapter - Easement, Eminent Domain, or Sale of Land or Other Security).
- B. **Prior Approval.** It is important that no major capital additions or reductions are performed without prior ORCF consent. However, in some instances when the additions or reductions were already completed without prior ORCF approval, a retroactive approval may be available. The same documents required in this section must be submitted. It should be noted although a retroactive approval is being processed, ORCF reserves the right to enforce its regulatory authority.
- C. **Additional Considerations.** The following issues will be considered by ORCF in processing a request for Major Capital Additions or Reductions of the mortgage security:
1. Financial and Physical Condition of the Project.
 2. Open ORCF and State Compliance Issues.
 3. Project’s PCNA (Physical Condition and Needs Assessment). If PCNA is more than 10 years old, ORCF may require a new PCNA to be performed.
 4. The value of the remaining project after approval will be unaffected by the Major Capital Addition or Reduction, or the value will still be sufficient to cover the remaining balance of the insured mortgage.
 5. Other relevant issues, information or documents as determined by ORCF.
 6. ORCF may also engage the services of the HUD OGC and OHP Architecture and Engineering and/or Appraisal teams to review all legal and technical issues.
 7. An environmental review as required by 24 CFR Part 50 will be conducted ~~in~~ accordance with Production, Chapter 7 on any proposal for remodeling, adding to, subtracting from, reconstructing, or demolishing a portion of the mortgaged project.

D. **Processing Time.** The concurrent reviews by HUD OGC and OHP Architecture and Engineering if required, will affect the length of processing time.

3.4.5

Surplus Cash Note Request

Upon receipt of a request for a Surplus Cash Note from the Borrower, the Servicer will review the request for completeness, accuracy and eligibility, determine cause for the Note, and provide any necessary supporting information to the AE, along with a recommendation for approval, modification or rejection. ~~The supporting information must include, but is not limited to: amount of request, purpose, terms and source.~~ A checklist will be made available on the Section 232 Program website.

~~The AE and Servicer will collaborate prior to HUD making a final determination.~~

Section 3.5

Nursing Home Surveys and Licensure

3.5.1

Introduction

The ORCF insures mortgages for skilled nursing facilities. This type of project is licensed, highly regulated, and routinely monitored by the State in which the project is located. Maintaining ongoing compliance with the State is critical in ensuring the quality of care provided to the residents and the success of the project over the life of the mortgage.

ORCF does not intend to intervene between the State and another Federal agency. ORCF monitors the FHA-insured portfolio and when it is clear that the project is not able to come into compliance, the project will be turned over to the Risk Mitigation Branch for special servicing and work-out efforts. Since the license is collateral for the FHA-insured mortgage, it is critical that the license remains intact and the residents of FHA-insured projects receive safe, sanitary, and decent housing.

~~As such, HUD provides State survey information to ORCF staff and FHA-insured Lenders that service the ORCF portfolio. This web-based dashboard captures health inspection reports for every FHA-insured skilled nursing facility, flags Special Focus Facilities or watch list designations, and provides other operational data relevant to the successful operations of the project. The portal has the functionality to critically analyze a specific project along with providing national benchmark data.~~

~~HUD is providing this portal to Lenders for incorporation in their servicing and underwriting model for all projects that are currently FHA-insured. If a Lender would like access to the site for their portfolio, they may email surveyresults@hud.gov.~~

~~Each Servicer must have a unique login and password to the survey performance database, and must periodically monitor their entire FHA-insured residential care facility portfolio.~~

This chapter will provide an overview of the inspection process and other tools the Center for Medicare and Medicaid Services (CMS) uses to rate and rank projects in order to help consumers, their families, and caregivers compare nursing homes in a specific area.

3.5.2

State Licensing and Surveys Overview

CMS contracts with each State to provide nursing home surveys that ensure that minimum Medicare and Medicaid quality and performance standards are being met. CMS, a part of the Federal government, certifies projects to receive payments from Medicare and Medicaid. Once certified the project is then a nursing home provider for Medicare and Medicaid services. Each State government oversees the licensure process for each project with that State. There are over 150 regulatory standards that nursing homes must meet at all times in order to ensure quality and performance standards. Meeting these minimum standards allows a project to receive Medicare and Medicaid payments and remain licensed with each State. If the regulatory standards are not being met, as shown through the survey process, then CMS can impose penalties, remedies or sanctions and possibly revoke all Medicare & Medicaid funding.

3.5.3

State Inspection Process

Nursing Home State Surveys and Health Inspection are two terms that describes the nursing home State Inspection process and the terms are often used conterminously, in conjunction and/or separately from each other (e.g., State Survey, Health Inspection Survey, State Health Inspection, State Inspection, etc.). States contract with CMS to monitor nursing homes that provide care to individuals that receive Medicare and Medicaid. Health Inspections of nursing homes are conducted routinely, about every 9-15 months, by the State survey team. The State will perform more frequent survey inspections if there are complaints or the project is poorly performing. During the nursing home inspection process the State reviews many aspects of quality and performance standards. The survey is comprised of an inspection team that is normally made up of trained inspectors which include but are not limited to a registered nurse, a licensed or certified social worker and a certified life safety code inspector. Surveys are performed unannounced to the project and can be performed 24 hours a day and can fall on any of the 365 calendar days. A survey generally lasts 3-5 days which can include non-business hours and/or weekends. The survey team routinely ensures residents are safe and free from immediate jeopardy. If severe deficiencies are found which has risen to the level of harm or immediate jeopardy then the survey may be extended. The survey team follows the survey process and evaluates whether the project is meeting individual resident needs and providing quality of care as defined by CMS. The survey covers various aspects of a resident's stay within a nursing home such as resident life, quality of care, safe and sanitary food preparation processes, staff/resident interactions, environment, policy and procedures and, among numerous others, abuse and neglect.

When an inspection team finds that a project does not meet a regulatory standard they issue a deficiency/citation. The State routinely allows 45 days from the date of the survey to correct deficiencies. The State also requires the project to provide a statement of correction to prevent the deficiency from occurring in the future. The State may follow up at the project by conducting another unannounced visit to the project or completing a desk review. If the deficiency is not corrected then the State recommends appropriate enforcement actions to the State Medicaid agency for Medicaid and to the regional office for Medicare. The CMS regional office determines a project's eligibility to participate in the Medicare program based on the

State’s survey results and the project’s compliance. If the regulatory standards are not being corrected then CMS can, depending on the severity of the violation, take action against the nursing home including imposing various remedies and possibly revoking all Medicare and Medicaid funding.

Nursing home surveys are posted on the Medicare.gov website.

3.5.4

State Inspection Process (Life Safety)

To be eligible to be a Medicare & Medicaid Nursing Home Provider the project must be in compliance with the 2000 edition of Life Safety Code (LSC). Projects that have waivers of the health occupancy provisions of the LSC or an acceptable Plan of Correction (POC) are also considered in compliance. The LSC is a set of fire protection requirements that provides a reasonable degree of safety from fire.

The LSC only uses qualified fire safety inspectors to perform the Life Safety Survey. The nursing home must also meet the minimum Life Safety Code at all times and will receive deficiencies for non-compliance of the Life Safety Code. The LSC inspectors will make reports and recommendations to the State agency. The State routinely allows time to correct a deficiency. If the regulatory standards are not being corrected then CMS can, depending on the severity of the violation, take action against the nursing home including imposing various remedies and possibly revoke all Medicare & Medicaid funding.

The Life Safety Surveys are located on the Medicare.gov website.

3.5.5

Quality of Care Provided to the Residents

The survey process each project undergoes is an effort of CMS to oversee that quality of care is being given to each resident. CMS has established Quality Measures that are used during the survey. These Quality Measures are measurable, valid, reliable and are submitted to CMS on a routine basis. The nursing home quality measures come from actual residents that stay within each project. This data is routinely collected and measures the resident’s physical and clinical conditions and abilities, as well as preference and life care wishes. This data is further converted to allow consumers to another source of information that shows how well nursing homes are caring for their resident’s physical and clinical needs. This data can be viewed on the Medicare.gov website.

3.5.6

Star Rating

CMS created a Five-Star Quality Rating System. This system is intended to assist family members, consumers and care givers to compare nursing homes more easily and help identify questions that they may wish to ask. The Five-Star Quality Rating System is located on the [Nursing Home Compare www.Medicare.gov](http://www.Medicare.gov) website. The website has a quality rating system that gives each of the 4 categories between 1 and 5 stars. Nursing homes with 5 stars are considered to have “much above average” quality and a nursing home with a 1 star rating is considered to have quality “much below average”. Though the categories and descriptions are subject to change, and the Medicare website is the most current and accurate location to read about details, at the time of publication, the four categories of the Star Rating are Overall, Health Inspections, Staffing, and Quality Measures. The actual star rating is based on technical guidelines to establish each star rating.

Overall Star Rating: Takes into account the other ~~three~~ categories (e.g. Health Inspections, Staffing and Quality Measures) and then gives an Overall Star Rating for the project.

Health Inspection: The health inspection rating contains information from ~~the last 3~~ previous years of onsite inspections, including both standard surveys and any complaint surveys. The most recent survey findings are weighted more than the prior ~~two~~ years, based on the technical guidelines.

Staffing: The staffing rating has information about the number of hours of care on average provided to each resident each day by nursing staff. This rating considers differences in the level of need of care of residents in different nursing homes.

Quality Measures: The quality measure rating has information on ~~10~~ different physical and clinical measures for nursing home residents. This information is collected by the nursing home for all residents. The Quality Measures offers information about how well nursing homes are caring for their residents' physical and clinical needs.

The Star Rating can be viewed on the [NursingHomeCompare.gov www.Medicare.gov](http://www.Medicare.gov) website.

3.5.7

Special Focus Designation

CMS has a Special Focus Facility Initiative that places a nursing home, with a history of serious quality issues, into a special program that is meant to stimulate the project to improve their quality of care to residents (see also, Section 3.10.4). Most of the projects placed on the Special Focus Facility Initiative Program have previously shown the following within the past three year survey history:

- A. Surveys have twice the amount of deficiencies as other nursing homes.
- B. More serious survey deficiencies than most other nursing homes. These deficiencies would include Harm and Injury experienced by the residents.

C. A pattern of problems that persisted over the past 3 years of surveys.

These projects are visited twice as often as regular projects (twice per year). Enforcement action becomes more stringent as more problems continue. There are three options after the project has been in the program and within the 18-24 month timeframe:

1. **Improvement and Graduation:** The project advances to an Improved Status and eventually Graduates from the program. This project would resume annual surveys and continue being a Medicare and Medicaid Provider.
2. **Termination:** This project has not met the criteria to graduate from the Special Facility Program, is not making progress and is terminated from providing services to Medicare and Medicaid recipients.
3. **Extension of Time:** An extension of time can be given to a project that is showing improved progress but not enough progress to advance to Improving/Graduated status. An extension of time could also be granted if there is a sale of the project.

Special Focus Designation can be found on the www.CMS.gov, www.NursingHomeCompare.gov and <http://www.medicare.gov/> website.

All Special Focus Facilities will be serviced by the Risk Mitigation Branch.

Section 3.6

Approval to Participate in HUD Programs - APPS and BPRS

3.6.1

Introduction

- A. The Office of Healthcare Programs' Section 232 Program requires the principals in a proposed transaction to submit certain types of forms containing information. This information is requested in order to demonstrate to HUD, their experience and the team of people who are planning to own, operate or manage a project with a Section 232 FHA-insured mortgage. Application submission requirements are contained in the application exhibits for new endorsement in accordance with the appropriate Section of the Act, including but not limited to, resumes, credit reports, and project licenses. In addition to proposed applications for a FHA-insured mortgage, a proposed change of Borrower (Transfer of Physical Assets), Change of Operator, or Change of Management Agent require approval by ORCF. These requirements can be found in Asset Management, Chapter 7 and Chapter 8.
- B. Regardless of the proposed transaction or event that triggers participant approval – i.e. newly proposed FHA mortgage insurance requests or change of entity--approval as a Section 232 Program participant by ORCF is a HUD requirement. ORCF uses ~~the Active Partners Performance System (APPS)~~ and ~~Business Partners Registration System (BPRS)~~ to ensure proper clearance and up-to-date information on participants doing business with HUD. This chapter provides an overview of the general steps necessary for participants in ORCF programs to receive approval via APPS and to register in BPRS.

3.6.2

Participation Requirements

- A. As stated above, principals in the proposed transaction(s) must submit information regarding their previous participation in governmental housing transactions, further outlined below in Section 3.6.3. Clearance via APPS is generated upon the submission of the Previous Participation Certification (Form HUD-2530) for approval for participation in any FHA-insured mortgage program. HUD encourages filing the Previous Participation Certification electronically. However, ORCF also accepts paper copies of the Previous Participation Certification for processing. The participant will be notified upon approval for participation based on APPS clearance. It should be noted that clearance of a participant via APPS does not necessarily mean that there are no further concerns (i.e. concerns with capacity or experience) with that entity. Approval via APPS simply confirms that there are no outstanding violations based on past experience with housing programs that have been

determined from the APPS database. Therefore, APPS approval is just one step in the participant approval process. ~~Participants should work with the ORCF staff processing the transaction to ensure their approval for the particular transaction under review.~~ The Previous Participation Certification submissions must be approved prior to issuance of a Firm Commitment or approval of a TPA or change of operator or Management Agent. Should participants change or revise the participants during a submission, the previous participation submittals must be revised and reapproved prior to closing or change of entity.

- B. HUD issued an APPS Users' Guide for the Industry (the Guide), found at: http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh/apps/appsindustryug. The Guide serves to provide specific details in registering and in using the electronic system. All ORCF Mortgagees and Borrowers who have been designated as APPS input contacts with secure access should become familiar with the Guide.
- C. The Guide further details the four types of Previous Participation Certification submissions: Baseline, Project, Organization Change and Identity Change. Project submissions include New Application for Mortgage Insurance, Refinance Application for Mortgage Insurance; New Role for Project, Transfer of Physical Assets. Organization Change Submissions and Identity Change also require ORCF review.
- D. In addition to APPS, HUD designed the BPRS, which is separate from the APPS Previous Participation Certification submission and approval process. Accurate, up-to-date data on participants (including names and addresses) is critical to smooth submissions in the REAC Financial Assessment Sub-System (FASS) which uses information from this system. This data is also used in HUD's ~~integrated Real Estate Management System (iREMS)~~ used by the AE.

~~For further information on BPRS and APPS, please visit HUD's website (www.hud.gov). Registering as a business partner and applying for a coordinator ID and Password is a four step process which is required to be done in this specific sequence:~~

- ~~1. First, a user needs to register in the Business Partner Registration system: http://hudapps.hud.gov/appspart_reg/apps040.cfm.~~
- ~~2. Second, after registration on the Business Partner Registration System, it is necessary to wait a 24 hours for the registration to take effect.~~
- ~~3. Third, apply as a Coordinator or User for Secure Systems on the Secure Systems Registration page.~~

~~If you are a Coordinator for a participant (entities/people), you can change all information except the TIN, Legal Structure and Ownership Type by accessing Edit Participant Detail from the Participant Processing drop down menu on APPS home page.~~

4. ~~Fourth, after the business partner registration has been completed, the user needs to go to: http://hudapps.hud.gov/public/wass/public/participant/partreg_page.jsp where a Coordinator/User can choose their password and indicate it on the Secure Systems Registration Page.~~

~~Once this has been completed, a Coordinator or User ID is mailed out within two (2) weeks to the Borrower/CEO.~~

~~Access key codes are mailed to the address in APPS. While requesting access codes, make sure the address you are confirming is the correct address. If not, correct the address before requesting access code. For corrections, contact your AE with documents showing correct information.~~

3.6.3

Principals Required to File Previous Participation Certifications

A. For any new project submission transaction, the following project participants are principals and must file either an electronic Previous Participation Certification APPS submission or a paper Previous Participation Certification:

1. Borrower
2. Management Agent
3. Operator
4. Master Tenant
5. General Contractor

B. For each principal that is one of the types of entities listed below, the following additional entities or individuals are also principals for APPS and Previous Participation Certification purposes:

1. Limited Liability Companies
 - a. All Managing Members regardless of their ownership percentage
 - b. All Members with 25% or more ownership in the Limited Liability Company
2. Limited Partnerships
 - a. All General Partners regardless of their ownership percentage
 - b. Limited Partners with 25% or more ownership

EXCEPT: Limited Liability Corporate Investors (LLCIs) may file a LLCI certification instead of the Previous Participation Certification (HUD-2530) form.

3. Corporations

- 1930 a. All Corporate Officers (President, Vice-President, Secretary, Treasurer,
1931 etc. This includes non-profit officers of the board of directors and staff
1932 members who are considered corporate officers)
1933 b. All members of the Board of Directors (this includes all non-profit board
1934 members)
1935 c. For publicly traded companies, all stockholders that own 10% or more of the
1936 company's stock
1937
1938 C. Other previous participation with HUD must be shown. Submittals via paper or electronic
1939 must contain details concerning other FHA-insured or funded projects in which the applicant
1940 has participated.

1941
1942 Note that, though the guidance presented here regarding Previous Participation Certification
1943 is current at the time of publication, the applicable requirements are subject to amendment
1944 from time to time via Rule, Notice or other means, in which case the more current
1945 publications will control over what is set forth herein.

1946 ~~HUD now accepts duly signed PDF signature packages in lieu of wet signatures for~~
1947 ~~electronic Previous Participation Certification submissions. Applicants may upload the duly~~
1948 ~~signed PDF packages instead of mailing the same. After uploading the PDF for Organization~~
1949 ~~changes, please send an email to your AE with a request for notification of Previous~~
1950 ~~Participation Certification submission package approval.~~
1951

- 1952 D. Previous Participation Certification signature authorization document exemptions:
1953
1954 1. If the president or CEO of a corporation signs for the entity, no other signature
1955 authority document is required.
1956
1957 2. If the managing member of an LLC is a person and signs on behalf of the entity, no
1958 other signature authority document is required.
1959
1960 3. If the GP of a partnership is a person and signs on behalf of the entity, no signature
1961 authority document is required.
1962
1963

3.6.4

Information Gathered

- 1964
1965 A. For both electronic APPS submittals and paper Previous Participation Certification
1966 submissions, HUD will check the following data sources for derogatory information, shown
1967 as critical findings or flags, on the entities being reviewed:
1968
1969 1. Government-wide Suspensions and Debarments that APPS downloads from the GSA
1970 Excluded Parties List System (EPLS).
1971
1972 2. Participant Flags that HUD staff entered into APPS.

3. PPRS/F19 Participant Flags that HUD staff originally entered into that system and which have been converted into APPS.

B. ORCF will further research any findings or flags and inform the Mortgagee or Borrower of the issues needing resolution. ORCF uses established procedures in placing or resolving a flag, including notifying a participant of the flagging, potentially impacting a participant's ability to do future business with HUD. The Processing Steps for an electronic submission (Previous Participation Certification) is found in Appendix 1 of this chapter.

C. Examples of Flag Reasons maintained in APPS include:

- Indictment or Other Formal Charge of Criminal Activity
- Debarment
- Deed in Lieu
- Mortgage Default
- Default – Surety Performance, Fidelity Bond
- False or Incomplete Previous Participation Certification
- Foreclosure
- Limited Denial of Participation
- Mortgage Assignment
- Mortgagee-In-Possession
- Suspension
- Suspension/Termination of Payment
- Unresolved Audit Findings
- Violation Regulatory Agreement

D. While some flags can be resolved by the AE, flags that cannot be resolved and therefore remain for historical purposes include the following:

- Debarment
- Deed in Lieu
- Foreclosure
- Mortgage Assignment
- Mortgagee-In-Possession
- Suspension

Accordingly, ORCF encourages all participants to check this information in the electronic system for accuracy and provide timely and responsive explanations when trying to do new business with HUD.

3.6.5

Procedure for Participants with Flags

- 2014 A. If the submittal contains any of the above issues that appear as flags in APPS, these issues
2015 must be addressed in the application for new business before approval of the transaction can
2016 occur. Therefore, no Firm Commitments will be conditioned on APPS approval, or only
2017 with special rare exception as discussed and approved by Loan Committee. This ~~explanation~~
2018 is also required for new entities involved with a Section 223(a)(7) refinance and/or change in
2019 participant requests in Asset Management~~Transfer of Physical Assets~~ approvals.
2020
2021 B. If the participant is found to have derogatory information in the APPS system, the ORCF
2022 Staff assigned to the project is required to address the specific issues via the loan committee
2023 memo or memo to the file for ~~other~~ asset management actions ~~such as a Transfer of Physical~~
2024 ~~Assets~~.
2025
2026 C. If the submittal contains derogatory information on the participant and these items cannot be
2027 resolved, the submittal will have to be submitted by the ORCF Underwriter or AE to the
2028 Workload Manager via a memo for approval.
2029

Section 3.7

Physical Condition

3.7.1

Introduction

The physical condition of every ORCF Section 232 FHA-insured facility is a critical factor in managing the overall risk to the FHA mortgage insurance fund to ensure the residents are residing in safe housing. ORCF strives to provide and promote the effective use of timely and reliable information to monitor and assess the condition of the ORCF Section 232 portfolio. Such assessment tools also provide valuable information to help ensure safe, decent and affordable housing is maintained throughout the ORCF Section 232 portfolio.

3.7.2

Physical Condition Monitoring Tools

A. Real Estate Assessment Center (REAC) Physical Inspections.

1. **General Background.** On September 1, 1998 (63 FR 35650), HUD published a final rule that established uniform physical condition stands for housing insured and or assisted under certain HUD programs. These standards are intended to ensure that this housing is decent, safe, sanitary and in good repair. The September 1, 1998 final rule also established uniform physical inspection procedures by which HUD determines compliance with the physical condition standards.
2. **REAC and ORCF Section 232 Projects.** HUD's Real Estate Assessment Center (REAC) is charged with responsibility for assessing and scoring the condition of certain projects in which HUD has an interest, including FHA-insured projects under the Section 232 Program, in accordance with the physical conditions standards and procedures of 24 CFR part 5 subpart G.
 - a. **ORCF 232 Projects.** ORCF will continue to use the Real Estate Assessment Center (REAC) to schedule and physically inspect all projects in the ORCF Section 232 portfolio unless stated otherwise below.
 - b. **Skilled Nursing Facilities.** This provision (24 CFR 200.855) is now applicable and it limits the inspections on skilled nursing facilities. It provides in part that REAC will no longer routinely perform physical inspections on skilled nursing facilities (though HUD can direct on a case-by-case basis that one be conducted). In applying this provision, HUD has halted the inspections on projects categorized in HUD's database as SNFs. This can include skilled nursing facilities that do have some non-skilled nursing units, but are predominantly providing skilled nursing care.

c. **Other Non-SNF Exceptions.** The provision also gives HUD the authority to determine that other (non-SNF) projects in a particular jurisdiction do not need REAC inspections if HUD finds that a particular jurisdiction provides adequate inspections with readily available results. Action, if any, with respect to that authority will be announced at a later date.

3. **Administration of REAC Inspections.** REAC inspects only a random sampling of the project to determine if the project is properly maintained. REAC conducts physical inspections through the use of contracted inspectors trained by REAC. The inspectors schedule on-site inspections with project Borrower's representatives. For assistance, questions, clarification, guidance and or questions, on procedures pertaining to REAC physical inspections, including scoring procedures and procedures and timelines to appeal an inspection report, refer to REAC's website ([see Appendix 3.2](#)).

4. **Exigent Health and Safety Items.** At the conclusion of a REAC Inspection, the inspector provides the Borrower, or designated contact, a list of all Exigent Health and Safety (EH&S) items. Once an inspection is conducted, the Borrower is responsible for mitigating all identified EH&S items within 72 hours, as verified by submission of the completed and signed certification to the assigned AE.

5. **Issuance of REAC Inspection Report.** REAC is responsible for verifying inspection data provided from the contracted inspector based on the on-site inspection. REAC scores and issues the formal REAC inspection report to the Borrower's contact, as verified at the on-site inspection.

6. **ORCF Actions and Referrals to the DEC in Response to REAC Inspection Report.** If the REAC inspection report score falls under 60 (on a scale of a possible 100 points) ~~twice~~ on two consecutive inspections, the AE will refer a Borrower to the Departmental Enforcement Center (DEC) for further review and possible enforcement action. Before referring to the Enforcement Center, the AE will review both inspections and discuss the results with the Lender to determine if the project make-up is causing improper scoring (locked doors or windows, or other characteristics unique to certain healthcare projects). ORCF will also flag the Borrower in HUD's Active Partners Performance System (APPS). The flag may adversely affect the Borrower's eligibility for participation in HUD programs, under HUD's Previous Participation Certification procedure, by constituting a standard for disapproval. All REAC Inspections receiving a score of 30 and below are automatically referred to the DEC for enforcement action.

a. **DEC Actions.** The DEC may arrange a conference call to discuss the inspection results with the Borrower and issue a Notice of Violation (NOV) demanding correction. Requirements of a Borrower that are included in the NOV include the following:

i. Conduct and submit a 100% survey identifying the physical deficiencies in the project;

- ii. Correct the physical deficiencies at the project including but not limited to those deficiencies identified in the REAC Inspection; and
- iii. Execute and provide a certification of corrections. Refer to: <http://portal.hud.gov/hudportal/documents/huddoc?id=10-04hsgnatt1.pdf>

The DEC may take additional enforcement action and seek any and all available remedies including to but not limited to, acceleration of the outstanding principal indebtedness, foreclosure, or any other appropriate remedies.

- b. **Follow-up and Monitoring.** In addition to mitigating EH&S items as described in A.4 of this chapter, Borrowers are responsible for correcting all deficiencies noted on physical inspection reports.

Borrowers are required to ensure a complete (100%) inspection of the project is performed. This follow up inspection shall include the site, all building exteriors, all building systems, all common areas, and all units. For clarification purposes: all areas within a building that are not residential units are considered common areas for inspection purposes. All deficiencies identified on a REAC Report must be corrected. To verify compliance, the Borrower must complete and sign the certification and provide it to their Lender and assigned - AE.

Lenders play a critical role in ensuring the Borrower has met their obligation to correct deficiencies and are encouraged to monitor progress and performance. Since the REAC Inspection is just a sample of the physical condition of the project, the 100% inspection of the project is important. Lenders should encourage the Borrower to, at a minimum, perform the following on an ongoing basis:

- i. Review of Exigent, Health, and Safety (EH&S) problems identified in the REAC physical inspection. These items should be considered a priority and should assure that all EH&S deficiencies have been and remain corrected.
- ii. Review of units and common areas to verify that significant REAC physical inspection report deficiencies (other than EH&S) such as falling retaining walls, broken sidewalks, exterior painting, etc. have been corrected

A Lender or HUD may decide to perform a site review of a project, to ensure deficiencies are addressed, should there be issues of concern with regard to the physical condition of the project.

Borrowers will be notified as subsequent REAC Inspections are scheduled by inspectors.

Any questions on REAC may be directed to the REAC Technical Assistance Center (TAC) at 1-888245-4860 or email at: REAC_TAC@hud.gov

- B. **State Surveys.** As discussed in Section 3.5, part of the State inspection process includes a Life Safety Inspection. As this inspection focuses on the compliance with fire protection requirements, it may reflect concerns with the physical condition of the project as it impacts the residents. ORCF regularly reviews the Life Safety Inspection as well as the entire State Survey and Medicare Star Ratings, to determine if there may be issues pertaining to the physical condition of the project. For more information on Life Safety, State Surveys and Medicare Star Ratings, refer to Section 3.5.

3.7.3

Resources for Addressing Physical Repairs and Improvements

- A. **Reserve for Replacement.** As discussed in Section 3.2.2 of this chapter, a R4R escrow exists for all FHA-insured and HUD-held mortgages, in accordance with the Regulatory Agreement. The R4R is established to help defray costs of replacing a project capital items. The R4R is a possible source of funding considered to help meet costs to maintain the physical condition of the project, in addition to the operating budget. A Borrower should work with their Lender and AE to seek approval of withdrawals from the R4R to address capital improvements and repairs. For more information on R4R, refer to [Asset Management, Chapter 4. Escrow Accounts](#) [Section 3.2.2 of this Chapter](#).
- B. **Other Resources.** As Borrowers are responsible for maintaining the project's physical condition, the Borrower may propose other resources of funding to be utilized to address needed physical repairs or proposed for capital improvements. Examples such as Borrower provided funding (not project funds); surplus cash notes, residual receipts are all [potential](#) sources ~~potentially contemplated~~ to address physical repair needs. [Compliance with regulatory and Section 232 Program requirements must also be ensured. Any Borrower contemplating capital improvements with additional funding sources must always consult the Lender and ORCF to ensure Regulatory compliance, as described in 17.4.](#)

3.7.4

Physical Condition and Regulatory Compliance

Borrowers and operators execute Regulatory Agreements under ORCF's Section 232 Programs. Part of the regulatory requirements described in the Regulatory Agreement is to keep the project in decent, safe and sanitary condition and in good repair. During any period in which HUD insures the Loan or holds a security interest on the Mortgaged Project, it is a Regulatory

- Violation for an Borrower or Operator, without Lender's and HUD's express written consent, to proceed to impact the physical condition of the project in any of the following ways:
- A. Make physical change, or permits changes to, the Mortgaged Project, whether negligently or intentionally, in a manner that reduces its value;
 - B. Fail to maintain the Mortgaged Project in decent, safe, and sanitary condition and in good repair; or
 - C. Materially fail to comply with covenants in the Note, the Borrower's Security Instrument, the Regulatory Agreement, or any of the Mortgage Insurance Documents respecting physical care, maintenance, construction, abandonment, demolition, or insurance against casualty of the Mortgaged Project.

3.7.5

Project Capital Needs Assessment

The intent of the Project Capital Needs Assessment (PCNA) is to ensure the long term viability of the project and ensure the proper deposit to the R4R account. When required by the project's Regulatory Agreement, the existing PCNA must be updated every ten years. Updates to the PCNA must follow the Statement of Work as set forth in Production, Chapter 4, for a Limited Scope PCNA. Updated PCNAs must be submitted to the Project's AE every ten years, as required (unless required prior to that date due to other circumstances). The cost of each such PCNA may be requested for reimbursement from the R4R account.

Section 3.8

Telecommunications Towers

3.8.1

Introduction

This section provides guidance for Borrowers regarding the procedures for requesting permission from ORCF to lease an area of the FHA-insured project for communication towers and/or other telecommunications equipment. A checklist of required exhibits to submit to HUD when requesting approval for communication towers and/or other telecommunications equipment is available on the Section 232 Program website.

3.8.2

General

ORCF supports Borrowers of FHA-insured projects leasing space for communication towers to telecommunication providers for the purpose of increasing revenue for the project. Pursuant to the Regulatory Agreement, the Borrower must submit the required documents ~~to the assigned AE for processing~~ prior to execution of the lease, as HUD approval is required for these types of commercial leases. The Servicer is to receive the request and documentation, review for completeness, accuracy and eligibility, and then forward to ORCF with a recommendation for approval~~The documents must also be submitted to the Lender for review and recommendation for approval, prior to HUD submission.~~ A review of the documents will focus on issues regarding any effect on the project's income and expenses, the Regulatory Agreement and Security Instrument. HUD closing attorneys and HUD engineering staff may review the required documents and provisions prior to the AE making a final determination.

3.8.3

Requirements

- A. **Contracts:** In the proposals for telecommunication contracts, the providers typically intend installing all necessary equipment on the project site at no cost to the project, and in return, the project receives lease payments. ORCF is supportive of these arrangements, provided that they bring a higher level of service to our communities in a more competitive atmosphere, increase project revenues, and enhance project marketability, and further provided that any associated physical, business, and legal risk involved with installation and maintenance of such towers is appropriately mitigated. Additionally, a HUD environmental review may be required before HUD approves a contract or lease for telecommunications towers.

- 2258 B. **Engineered fall distance.** All structures shall be located outside the engineered fall distance
2259 of any support structure for high voltage transmission lines, radio antennae, satellite towers,
2260 cellular towers, etc., as discussed in Production, Chapter 7.5.K.2.
2261
- 2262 C. **Lease:** The following points are to be taken into consideration:
2263
- 2264 1. The lease may not be modified, extended or terminated without the prior written
2265 consent of the Lender.
2266
 - 2267 2. The lease may not be modified or extended without the prior written consent of HUD.
2268
 - 2269 3. The lease must be assignable by the Lessor to the Lender and/or HUD (i.e., upon
2270 foreclosure or deed-in-lieu of foreclosure).
2271
 - 2272 4. The lease is subordinate to the HUD-held or FHA-insured Mortgage (Security
2273 Instrument).
2274
 - 2275 5. The lease will not be automatically terminated by foreclosure or any other transfer of
2276 the mortgaged project; and, that in the case of foreclosure or deed-in-lieu of
2277 foreclosure, the Lender and/or HUD shall have the right to accept or terminate the
2278 lease.
2279
 - 2280 6. The lease must contain a clause that states that the Lessee shall, upon receipt of notice
2281 of default under the Mortgage (Security Instrument), pay all rents payable under the
2282 lease to the Lender and/or HUD.
2283
 - 2284 7. The lease must contain the following information:
2285 a. a comprehensive list of the equipment to be installed, including a list of any
2286 proposed improvements to the FHA-insured project;
2287 b. Lessee is responsible for the maintenance of the equipment;
2288 c. maintenance schedule;
2289 d. access information; and
2290 e. where the equipment is located (i.e., roof) along with a drawing of the
2291 location.
2292
 - 2293 8. The lease shall contain a provision which conditions approval of the lease on the
2294 Lessee obtaining all variances, permits, license or approvals required by applicable
2295 law.
2296
 - 2297 9. The lease must contain a certification from the Lessee that it has performed its own
2298 investigation of the project and has determined its suitability for use.
2299
 - 2300 10. The lease may contain a provision granting the Borrower, its successors and assigns
2301 the right to relocate any equipment, wiring or cabling.
2302

- 2303 11. The lease must contain a provision permitting the Borrower, its successors and
2304 assigns the right to terminate the lease should, 1) Lessee default in payments owed
2305 under the lease, 2) Lessee's authorized use of the premises materially interfere with
2306 Borrower's use and operation of the project and building, or, 3) it be determined that
2307 the Lessee's equipment constitutes a danger to the health and safety of the project's
2308 residents or poses a danger to the structural integrity of the building.
2309
- 2310 12. The lease must contain a provision mandating that hazardous waste materials will not
2311 be stored, used, generated, etc., on or in the FHA-insured project at any time.
2312
- 2313 13. Anti-Deficiency Provision: in no event shall HUD be subject to an indemnification
2314 provision in the lease, whether in the present or future (if it becomes Lessor to the
2315 lease).

Section 3.9

Commercial Space

3.9.1

Introduction

A. General Guidance

This section provides guidance pertaining to ORCF’s requirements related to additions or alterations to commercial space on projects currently insured under any of the programs covered by this Handbook.

B. Categorization of Space.

Commercial space in a Healthcare Facility can be categorized as a space within the project that has been altered or converted for use other than residential purposes from which income is derived or anticipated. In accordance with **24 CFR 200.73**, a project may include such commercial and community facilities as the Commissioner deems acceptable. Commercial space differs from community space or community facilities. The term “community facilities” refers to project amenities, such as a pool, resident parking/parking garage, business center or fitness center that are predominantly used by residential tenants, with or without charging additional fees. Community facilities generally do not produce regular income and any intermittent revenue is to be included as ancillary income.

3.9.2

Types of Commercial Space for Assisted Living, Intermediate Care, and Skilled Nursing Facilities

Commercial Space vs. Community Space. Generally speaking, due to the special nature of these types of projects, commercial space is to be limited to commercial activities that benefit the type of residents that live in the project. Unless the project has been constructed as a mixed use building, the project shall include commercial activities that are consistent with the type of project and type of residents served. Common Commercial Space areas in ALF, Intermediate Care Facilities (ICF), SNF and Board and Care Facilities include, but are not limited to: hair salons, convenience stores, specialized medical care provider spaces, ice cream parlors, coffee shops, gift shops and non-resident parking. These are deemed “commercial” instead of community spaces if they are income producing on a consistent basis and gain their revenue from residents and customers on a “pay for service” basis separate from the monthly bed charge. Residential parking, if a fee is charged to residents, is still considered community space and is recorded as ancillary income, not commercial income for the purpose of the calculations and limitations below.

3.9.3

Space and Income Limitations

This section provides guidance pertaining to when a Borrower wishes to change the intended use of part of a project to commercial space.

A. **Commercial Space and Income Limit Computations.** Commercial Space and Income is limited to 20 percent of the total gross floor area of the property and 20 percent of the Effective Gross Income of the project Commercial Space that is intended to exclusively serve the residents of the project is not counted toward the 20 percent limit.

B. **Non-Compliance and Retroactive Approval.** There may be instances in which residential space is converted to commercial use without the knowledge of HUD. ORCF shall inform the project Borrower, in writing, that such action is in violation of the Regulatory Agreement and that failure to correct this violation may result in HUD exercising its rights under the Regulatory Agreement, including denial of future participation in HUD programs. ORCF may approve the conversion retroactively, in its determination, provided all requirements are met.

C. **Parking.**

1. Parking income attributable to residential tenants is considered to be ancillary income and is not included in the limits contained in Section A, above. Commercial parking spaces reserved for use by motorists who are not project residents or are not parking to use the on-site commercial tenant's facilities, and the related non-tenant parking income, must be included in the Commercial Space and Income limitations. The income and space attributable to parking spaces reserved for non-residential or non-commercial tenants must be included in the limitations, based on applying the percentage of the total spaces that are reserved for non-tenant use. For existing projects that are to be acquired, refinanced or will undergo substantial rehabilitation, that provide parking for a monthly fee, the Lender must identify the percentage of monthly parkers who are non-tenants so as to include these in the commercial income limitations, above. The maximum occupancy factor to be applied to the parking income attributable to parkers who are not associated with either the project's residential or commercial tenants shall be the lower of:

- a. The amount indicated by the market and by the historic performance of the subject, or
- b. 50 percent.

2. If the Borrower operates a parking facility that provides parking for residential or commercial tenants of the project, the Lender must determine parking income based on an analysis of the past 3 years of operation and the trailing 12 month period prior to application.

- 2395
- 2396 3. If the parking facility is operated by a third-party, the Lender may use the amount of
- 2397 income collected under the contract if it is a fixed monthly payment. Parking
- 2398 contracts that specify a percentage rent in addition to or in place of a fixed rent are
- 2399 not permitted without ~~a waiver~~HUD approval.
- 2400
- 2401

3.9.4

Submission Requirements and HUD Review

- 2402
- 2403 A. Submission Requirements. Please see the list of exhibits ~~listed~~provided on the checklist
- 2404 posted on the Section 232 Program website. The Servicer is to receive any requests for
- 2405 additions or alterations to commercial space, review them for completeness, accuracy and
- 2406 eligibility, and then forward them to ORCF with a recommendation for approval~~The~~
- 2407 ~~checklist discusses the logistics of the submission.~~
- 2408
- 2409 ~~B. Processing. The AE will notify the project Borrower/operator of any deficiencies in the~~
- 2410 ~~package, and will notify the Borrower/operator and mortgagee promptly when a decision has~~
- 2411 ~~been rendered.~~
- 2412
- 2413 ~~C.B.~~ **Additional Considerations.** The following issues will be considered by ORCF in
- 2414 processing Commercial Leased Applications:
- 2415
- 2416 1. Current Financial and Physical Condition of the Project.
- 2417
- 2418 2. Open Federal, State, and local compliance Issues.
- 2419
- 2420 ~~D. Decision on Request for Approval. After consideration of the Borrower's request for~~
- 2421 ~~approval and the materials submitted in connection with the request, the Asset Management~~
- 2422 ~~Branch Chief or Senior AE must notify the Borrower and the mortgagee in writing of the~~
- 2423 ~~approval or disapproval of the proposal and provide the reasons for such determination.~~
- 2424

Section 3.10

Special Circumstances Requiring the Notification of the Servicer and/or AE

3.10.1

Introduction

Throughout this portion of this chapter there are indicators that require a Borrower and/or Operator either to notify the Servicer and the AE concurrently, or to notify only the Servicer (who would in turn elevate the matter to the AE as appropriate) of a Project's risk, of an action ~~or improvement~~ plan or of progress on previously reported situations. ORCF has created a sample format that Servicers may use in reporting this information; the sample may be found on the Section 232 Program website.

3.10.2

Failure to Make Lease Payment

- A. The Servicer and AE must be immediately notified by the Borrower of a failure to make a Lease payment.
- B. The Servicer and AE will work with Borrower and Operator to understand the financial or business circumstances that have resulted in the non-payment, and try to facilitate an action plan that will remedy the non-payment status.
- C. The Servicer will continue to monitor the situation, to ensure timely payments continue in the future.
- D. Borrowers and Operators are strongly encouraged to work together with the Servicer to facilitate remedies to any problems with the Lease payments because the Servicer can be of assistance in such scenarios. If the Servicer knows of the payment status early enough, they may be able to work with the Project to create an action plan and remedies with the parties before any non-payment penalties are incurred.
- E. In the event of a non-payment related to a Borrower/Operator dispute or other non-financial reason, the Servicer must contact the AE to discuss the severity of the situation and whether it should be transferred to the Risk Mitigation Branch.

3.10.3

Default of Master Lease

- A. Notification of Default of a mMaster lease must be provided from Borrower to Servicer and HUD within two (2) business days following the Borrower's receipt of the notification.
- B. Once notified, Servicer will evaluate other projects within the mMaster lease, to determine cash flows and the ability to cover the failing project(s). The Servicer will collaborate with HUD.
- C. Default on a mMaster lease will impact the Project, legal documents, and potentially a default on the mortgage. The project will may also need to be serviced by the Risk Mitigation Branch.

Additional details regarding master leases may be found in Production, Chapter 13.

3.10.4

Special Focus Facility

CMS has a Special Focus Facility Initiative that places a nursing home, with a history of serious quality issues, into a special program that is meant to stimulate the project to improve their quality of care to residents (see also, Section 3.5.7).

- A. Notifications to HUD and the mortgagee (Lender/Servicer) are required to be submitted within two (2) business days after the date of receipt of notice of a Special Facility Focus (SFF) designation from a state or federal regulatory agency, unless a longer time period is approved by HUD.

Failure by the Project to notify HUD and the Servicer of a SFF designation will be deemed a violation of federal regulation 24 CFR 232.1015 and may lead to the involvement of the HUD Departmental Enforcement Center (DEC).

- ~~B. Though it is a mandatory responsibility of a project to notify the AE and the Servicer of their SFF status, all Section 232 Program Servicers are to monitor the CMS SFF status list no less than monthly, to determine if any projects in their portfolio have been added to the SFF list or had a status change while on the list. If discovered on the list, the Servicer is to immediately contact the Project and the AE.~~

The Special Focus Facility list may be found at the following web address:

<http://www.cms.gov/Medicare/Provider-Enrollment-and-Certification/CertificationandCompliance/downloads/sfflist.pdf>

~~C.B.~~ The Servicer and AE will work with the Operator (and, as applicable, the Borrower and Management Agent) to establish an action plan for being removed from the SFF list.

~~D.C.~~ The AE will reassign the project to the Risk Mitigation Branch for ongoing servicing.

~~E.D.~~ Each Project and situation is unique; some may show improvement and move off the SFF list faster than others. The Servicer and AE (Risk Mitigation Branch member) will work with the Project to establish an ~~a~~Action ~~p~~Plan.

3.10.5

State Inspections

A. **Reporting Requirements.** Keeping the Lender and ORCF informed of problematic surveys and of any actions that could threaten the licensure or provider payments for a project is crucial, since such matters can threaten the viability of operations that are needed to meet operating expenses and make mortgage payments.

1. Except as limited in 3.10.5.A.2, HUD requires reporting when the Operator receives a notice, report, survey or other correspondence (regardless of form) from any governmental entity that includes any statement, finding or assertion that:

- a. Operator (or any principal, officer, director or employee of Operator), any Management Agent, the Project, or any portion of the Project is or may be in violation of or default under any of the Permits and Approvals or any governmental requirements applicable to the operation of the Project, or
- b. Any of the Permits and Approvals are to be terminated, limited in any way, or not renewed; or
- c. Any civil money penalty (other than a de minimus amount) is being imposed with respect to the Project, or
- d. Operator (or any principal, officer, director or employee of Operator), any Management Agent, the Project, or any portion of the Project is subject to any governmental investigation or inquiry involving fraud.

2. Reporting is only required with relation to Licensed Nursing Facility surveys when a survey has any findings higher than a “G” level or any repetitive “G” level or higher findings from prior surveys (pursuant to CMS State Operations Manual, Chapter 7, as may hereafter be edited or updated, or any successor guidance). Repetitive is defined as “unresolved from the two most recent consecutive surveys or a repeat violation having the same citation number”.

3. **Reporting Logistics.** Unless otherwise requested by HUD or the Lender:

- a. The *initial* communication from the Operator pursuant to this Section shall be a notice by email to the Lender (not to HUD) describing the conduct cited, the scope and duration of remedy(ies) imposed, and the timelines for corrective actions (not the survey or other extensive communication itself). Such email

- shall be sent within two (2) business days of receipt of the notice, report, survey, or other correspondence from the governmental entity.
- b. The *next* communication from the Operator shall be email notification to the Lender that the issue(s) have been addressed to the satisfaction of the issuing regulatory agency.
 - c. The Lender shall notify the AE immediately when a matter listed in Section 3.10.5.A.1 is reported by the Operator that is not expected to be readily resolved or poses an immediate threat to licensure or funding. If necessary, the Lender should work proactively with the operator to ensure the issue(s) are addressed to the satisfaction of the issuing regulatory agency. The Lender may use an optional reporting form made available by ORCF for reporting these or other matters of concern regarding the financial or operational performance.
- B. The receipt by HUD and/or Lender of notices, reports, surveys, correspondence and other information shall not in any way impose any obligation or liability on HUD, Lender or their respective agents, representatives or designees to third parties to take (or refrain from taking) any action, and HUD, Lender and their respective agents, representatives and designees shall have no liability to third parties for any failure to act thereon or as a result thereof.
- C. Failure to notify the AE and the Servicer of such inspection reports, Plans of Correction, approval reports or other qualifying communications, will be a violation of federal regulation 24 CFR 232.1015, as well as the operator regulatory agreement, and may lead to the involvement of the HUD Departmental Enforcement Center (DEC).

3.10.6

Legal Judgments

The Borrower and the Operator must each notify their Servicer within two (2) business days of receiving a legal judgment, penalty or fine against the Project, in excess of \$50,000.

- A. The ability to cover a judgment/penalty/fine will vary based on the size of the project, the available cash, etc. The Servicer will work with the Project to discuss reasons for the judgment and impacts on the financial status of the Project, notifying the AE of outcomes. The Operator must provide the Servicer with an action plan (seeking the Servicer's guidance, as necessary and appropriate), and must work with Servicer to analyze the impact of the judgment, providing information to the AE of the status, until financial stability is regained.
- B. Depending on the financial position of the Project and its ability to absorb the imposed judgment, it may require a change to "Potentially Troubled" status in the HUD system, by the AE.

3.10.7

Professional Liability Insurance

On an annual basis, the Servicer must verify that each Project has the required Professional Liability Insurance (PLI) coverage, as approved during the Project's underwriting. This review must include a current copy of the insurance ACORD, PLI policy, certificate or memorandum of insurance or other evidence of the required insurance coverage, as well as review of the updated loss history, consistent with the underwriting review standards (Section II, Production, Appendix 14.1.VII.D)

1. If coverage is less than required, then the Servicer must work directly with the Project to resolve the coverage deficiency.
2. If the coverage deficiency is not readily resolved, then the Servicer must notify the AE and monitor the Project until the coverage is adequately provided.
3. ~~The AE will maintain the Project with a "Potentially Troubled" status in the HUD system and the Servicer will monitor it, until the coverage is adequately provided. If the review of loss history indicates a negative trend in claims, the Servicer must evaluate the situation, discuss with the Operator any financial or operational changes that may be warranted, and discern the Project's financial ability to absorb any ramifications imposed by the claim(s). If appropriate, the Operator must establish an action plan. The Servicer will involve the AE as they deem appropriate.~~
 - A. ~~The Project must notify their Servicer within two (2) business days of any filing of one million dollars (\$1,000,000) or greater PLI claim against the Project.~~
 1. ~~The Borrower must review the circumstances of the claim, and provide the Servicer with analysis of financial, operational and/or healthcare impacts, and a plan of action to address such contingencies. The Servicer will involve the AE as they deem appropriate.~~
 2. ~~Depending on the financial position of the Project and its ability to absorb any ramifications imposed by the claim, the filing may require a change to "Potentially Troubled" status in the HUD system, by the AE.~~

3.10.8

Fidelity Bond Coverage

On an annual basis, the Servicer must verify that each Project has the required Fidelity Bond/Employee Dishonest coverage, as approved during the Project's underwriting.

~~A. The Fidelity Bond or coverage must name the Mortgagee and HUD as additional loss payees.~~

~~B.A.~~ If coverage amount is less than required (at least two months annualized potential gross income receipts, as required at the time of HUD Project approval), then the Servicer must work directly with the Project to resolve the coverage deficiency.

~~C.B.~~ If the coverage deficiency is not readily resolved, then the Servicer must notify the AE.

~~D.C.~~ The ~~AE will maintain the Project with a “Potentially Troubled” status in the HUD system~~ and the Servicer will must monitor the Project, until the coverage is adequately provided.

3.10.9

Notification of Termination of Insurance

- A. A project cannot be uninsured in the Section 232 Program. The Project must notify their Servicer and AE within two (2) business days of its receiving notification of any termination of insurance.
- B. The Operator must provide the Servicer with an action plan (seeking the Servicer’s guidance, as necessary and appropriate), and must work with Servicer to resolve the circumstances surrounding the notification, providing information to the AE of the status, until resolution is reached.
- C. Termination of insurance or the formal notification of a potential termination of insurance will immediately warrant a change to “Troubled” status in the HUD system until the issue is resolved.

Failure to notify the AE and the Servicer of such notifications will be a violation of federal regulation 24 CFR 232.1015, and may lead to the involvement of the HUD Departmental Enforcement Center (DEC).

3.10.10

Threat to Abandon Project

- A. The Borrower must notify their Servicer within two (2) business days of any threat to abandon the Project, when initiated by the Borrower or Operator. This is separate from an inspection/ survey decertification.
- B. The Servicer must investigate the threat to abandon the project, and attempt to mediate a resolution. The Servicer must escalate the threat to the AE if it becomes more imminent and/or cannot be resolved quickly without HUD involvement.

3.10.11

REAC Inspections

A. The Borrower must notify their Servicer within two (2) business days of receiving a REAC score of 30 or below or a second REAC inspection score below 60.

1. A score of 30 and below creates an automatic REAC referral to the DEC and must be addressed immediately.
2. A second consecutive score of below 60 will warrant a referral to the DEC and must be addressed immediately.
3. The Servicer must assist the Project in determining if an appeal of the inspection score is appropriate, and provide assistance in preparing the appeal to REAC.

Appeals to REAC have extremely time-sensitive deadlines which must be met. Please reference the Physical Condition portion of this chapter for more details on the REAC appeals process.

4. The Servicer must review the inspection report to ensure repetitive findings are being addressed and physical plant items are taken care of immediately.

~~Depending on the significant finding levels and repetition of findings without appeals or justification, a change to “Potentially Troubled” status in the HUD system, by the AE, may be necessary. The Servicer and AE should discuss the circumstances prior to a status change.~~

3.10.12

Accounts Receivable Loans

As further defined in the Production, Chapter 15 and Asset Management, Chapter 10:

A. When a Project proposes to add or amend an Accounts Receivable (AR) loan, it must be reviewed with the same scrutiny that such a loan would be reviewed during the initial underwriting process. The Project must submit the required documentation to the Servicer, who will review the information for completeness, accuracy and eligibility, and then forward the submission to ORCF with a recommendation for approval. ~~and submit the request to HUD for the AE to process.~~

1. A change in the AR loan status initiated due to extenuating circumstances that have adversely impacted the Project (rather than straightforward changes in business) should be evaluated by the Servicer and brought to AE's attention for particular scrutiny. If the AR loan change is a straightforward change in the loan, there would

be less of a concern than the need for a new loan due to a change in provider payments or other financial burdens.

~~2. Circumstances may trigger a “Potentially Troubled” or “Troubled” status in the HUD system, by the AE. The Servicer and AE should discuss the circumstances prior to a status change.~~

B. The Project must notify their Servicer within two (2) business days of any notification of default on its Account Receivable (AR) loan.

1. Default on an AR loan may be an indicator of potential default on the mortgage. Therefore, once notified, the Servicer must evaluate why the AR Loan has defaulted, reviewing cash flows and the ability to cover the failing loan, and work with the Project to create an action plan for moving the loan out of a default status.

~~2. Default on an AR loan will trigger a “Potentially Troubled status in the HUD system, by the AE. The Servicer and AE should discuss the circumstances prior to a status change.~~

~~3.2.~~ The Servicer must collaborate with AE (and Risk Mitigation Branch, if assigned) as necessary until the remedies are put in place and the action plan has been fully implemented.; ~~The Servicer and~~ must also monitor the Project closely to ensure financial and operational viability are restored, until it is able to return a Not Troubled status.

3.10.13

Unauthorized Distributions

A. The Borrower must notify their Servicer within two (2) business days of receiving a Notification of Unauthorized Distribution by the HUD Financial Assessment Subsystem (FASS).

1. The notification also includes a designated cure period which must be adhered to.
2. This notification is sent automatically to the email the Project registered in the system when an unauthorized distribution has been determined by FASS, as well as to the AE. The AE must also immediately notify the Servicer of the violation.
3. The Borrower and, where applicable, the Operator, must provide the Servicer with an action plan (seeking the Servicer’s guidance, as necessary and appropriate), and must work with Servicer to ensure the cure period will be met to resolve the violation, and to further review the circumstances leading to the violation. The unauthorized distribution may be a sign of financial distress that needs to be closely monitored, and an action plan may need to be put in place to do so.

4. The Servicer must notify the AE if there are extenuating circumstances that are preventing the immediate submission of the action plan, and provide the AE with the action plan expeditiously, and assure that the funds are repaid within the cure period.

- B. There are times when REAC/FASS findings trigger contact from the DEC directly to the Project. Although the AE is also copied on such the notification, and must notify the Servicer, the Borrower is responsible for notifying the Servicer within two (2) business days of receipt of a REAC/FASS notification from the DEC.

The Servicer will then work with the Project to cure the violation or devise an action plan to cure the finding(s), including the AE as appropriate, and communicating with the DEC during the process.

3.10.14

Bankruptcy

- A. The Borrower and Operator must notify their Servicer within two (2) business days of any bankruptcy petition related to any of the Project participants who may file for bankruptcy (i.e. Borrower, Operator, or Management Agent).
- B. The Servicer must review the bankruptcy status and circumstances, and within two (2) business days of being notified by the Project, must provide the AE with the specifics of those circumstances, including, but not limited to: bankruptcy type, contact information of the participants and their respective legal counsels, the reason for petition, and whether the petition is voluntary or involuntary.
1. A copy of the bankruptcy notice must also be provided to the AE at this time.
 2. Generally speaking, a bankruptcy status will warrant transfer to the Risk Mitigation Branch portfolio due to the troubled nature of the project. Upon the initial notification of imminent bankruptcy, the AE will transfer the Project to the Risk Mitigation Branch.
- C. The Project must notify their Servicer of any imminent bankruptcy proceedings of which it is aware. The Servicer must notify the AE of the imminent bankruptcy within two (2) business days of such knowledge.
1. Until an FHA insurance claim is filed, HUD expects the Servicer to fully participate in the bankruptcy proceedings. Unless, and until, HUD intervenes in the proceedings, the Servicer is expected to guard HUD's interests and keep HUD fully informed as to the case's progress and major developments.
 2. The AE will assign the Project to the Risk Mitigation Branch, if warranted.

- 2795
- 2796 3. The Servicer should be reviewing the bankruptcy to ensure:
- 2797 a. The nursing home license, certificate of need, and provider agreements remain
- 2798 with the project
- 2799 b. Rights to the operator's account receivables ("AR") remain with the Project or
- 2800 are paid towards AR financing approved by HUD for the Project's benefit
- 2801 c. Lease payments are be sufficient to cover debt and R4Rrequirements
- 2802 d. Compliance with all covenant remains intact
- 2803 e. Mortgage and security instruments remain enforceable in accordance with
- 2804 their terms
- 2805 f. All Regulatory Agreements pertaining to the Project remain in effect and the
- 2806 parties to these agreements are complying with the requirements contained
- 2807 therein.
- 2808 g. All actions required of the Servicer under Mortgagee Letter 91-17.
- 2809
- 2810 D. Particularly for Projects under a master lease, it will not be unusual for a Project to be
- 2811 involved in bankruptcy proceedings without there being a monetary default; however it is
- 2812 still necessary for the Servicer to work closely with the troubled Project, and other projects
- 2813 within the master lease, to ensure that the bankruptcy has as minimal an impact as possible
- 2814 on the other projects, and to avoid further financial disruption in the other projects.
- 2815
- 2816 E. The Servicer must provide routine bankruptcy status updates to the assigned AE and/or their
- 2817 designee. The Servicer may also be responsible for working with the Risk Mitigation
- 2818 Branch, OGC, DEC and/or a Department of Justice (DOJ) legal team.
- 2819
- 2820

3.10.15

Delinquent Mortgage Payments

- 2821
- 2822 A. Delinquent mortgage payments are not only a violation of legal obligations by the Borrower,
- 2823 but are also a sign of financial distress for a Project and are to be closely monitored by the
- 2824 Servicer. The Borrower is required to notify the Servicer ~~and the AE~~ if the mortgage
- 2825 payment is delinquent as of the 16th of the month.
- 2826
- 2827 B. The Multifamily Delinquency and Default Reporting (MDDR) System will notify the AE of
- 2828 a delinquency after the 16th of the month. The AE will reach out to the Servicer for a status
- 2829 of the delinquency and expectations of when the payment will be made.
- 2830
- 2831 C. Upon notification of a delinquency, the Servicer must work with the Borrower (and Operator,
- 2832 if applicable) to ascertain the financial, operational and/or other circumstances leading to the
- 2833 non-payment, including, but not limited to evaluating the ability of the Borrower to pay the
- 2834 mortgage, any anticipation of payments to be made, the financial strength of the Borrower
- 2835 (and Operator), recent state survey results, extenuating circumstances and other concerns
- 2836 potentially leading to the delinquency.
- 2837

- 2838 D. The Operator must provide the Servicer with an action plan (seeking the Servicer's guidance,
2839 as necessary and appropriate). The Servicer must then notify the AE of situation, and
2840 provide the AE with an action plan to remedy the delinquency.
2841
- 2842 E. The Servicer and AE may also, at this time, request and review financial reports from the
2843 Project to determine an action plan.
2844
- 2845 F. Once notified of the delinquency, if no action from the Borrower or Servicer has taken place
2846 by the end of the month, the AE will work directly with the Servicer and Borrower to
2847 escalate the action plan.
2848
- 2849 ~~If the delinquency has not proven to be a chronic occurrence or the Project is not in monetary~~
2850 ~~default, it will need to be monitored by the Servicer, but may not warrant a change to~~
2851 ~~"Potentially Troubled" status in the HUD system. However, if the Project is already in PT~~
2852 ~~status, or if there is evidence of rolling default status, the AE will downgrade the HUD~~
2853 ~~system status and increase the monitoring, in coordination with the Servicer.~~
2854
- 2855 G. The Servicer will monitor any mortgage payment that is over 30 days delinquent until it is
2856 paid.
2857
- 2858 H. Once a non-payment has aged between 45 to 60 days, and no evidence of payment is
2859 anticipated, the Servicer must again notify the AE and provide additional information
2860 regarding cash flow problems or other circumstances within the Project that have led to the
2861 delinquency.
2862
- 2863 At this stage, the project will be ~~evaluated to determine if a~~ transferred to the ~~ORCF~~-Risk
2864 Mitigation Branch ~~is warranted and/or~~ to escalate the HUD involvement with the Borrower
2865 (and Operator) in an effort to avoid default of the loan. The Project will also be ~~changed to a~~
2866 ~~"Troubled" status in the HUD system for ongoing monitoring~~ until the financial status, and
2867 mortgage payments, return to a stable level.
2868
- 2869 I. For systemic late fees and delinquencies, but not beyond 30 days, the Servicer may use
2870 discretion in involving the AE, but must notify HUD if this occurs more than 6 out of 12
2871 months. These systemic delinquencies may not necessarily warrant transition to the Risk
2872 Mitigation Branch ~~nor~~ indicate a "Troubled" project, but further evaluation will be required.
2873